

3 1761 11849482 2

Cage

CA2ΦN

Z1

-65A01


v. 2

Ontario. Royal Commission on
atlantic acceptance

Report

v. 2

1969



Digitized by the Internet Archive
in 2024 with funding from
University of Toronto

<https://archive.org/details/31761118494822>



I

51

REPORT
of
THE ROYAL COMMISSION
APPOINTED TO INQUIRE INTO
THE FAILURE
of
ATLANTIC ACCEPTANCE CORPORATION
LIMITED

THE HON. S. H. S. HUGHES

VOLUME TWO

September 12, 1969



PRINTED AND BOUND IN CANADA

CORRIGENDA
in
VOLUME TWO

✓ **Page iii, last line**

For "223"
read "123"

✓ **Page 718, line 23**

For "Willson Stationery"
read "Willson Stationers"

✓ **Page 753, line 11**

For "obained from"
read "obtained from"

✓ **Page 874, line 20**

For "General Spray Services"
read "General Spray Service"

✓ **Page 1028, line 23**

For "General Spray Services Inc."
read "General Spray Service Inc."

✓ **Page 1174, line 38**

For "Horen and Pitfield Foods Limited"
read "Horne and Pitfield Foods Limited"

Summary of Contents

VOLUME 1

The Commission	iii
Letter of Transmittal	vii
CHAPTER I Default	1
CHAPTER II The Early Days	34
CHAPTER III Structure and Growth of the Atlantic Group	60
CHAPTER IV The Loss	92
CHAPTER V Three Acquisitions	106
1. Commodore Sales Acceptance Limited	106
2. Aurora Leasing Corporation Limited	146
3. Adelaide Acceptance Limited	181
CHAPTER VI The John Belli Affair	189
CHAPTER VII The London Complex	208
CHAPTER VIII Commodore Business Machines and Associated Companies	289
CHAPTER IX Lucayan Beach and Dalite	494

VOLUME 2

CHAPTER X The Hugo Oppenheim Bank	679
CHAPTER XI Racan Photo-Copy Corporation	738
CHAPTER XII The Nevil Group	791
CHAPTER XIII Valley Farm and Enterprises Limited	830
CHAPTER XIV Other Major Loans	860
CHAPTER XV British Mortgage & Trust Company	963

VOLUME 3

CHAPTER XVI The Deeds of Trust	1266
CHAPTER XVII The Riddle of the Accounts	1343
CHAPTER XVIII Motives and Methods of C. P. Morgan	1453
CHAPTER XIX The Effect of the Atlantic Failure on the Money Market: The Abell Report	1520
CHAPTER XX Summary and Recommendations	1569
Acknowledgments	1691
Index	1697

VOLUME 4

TABLES AND APPENDICES

Tables	1
Appendices	223
	123

EDITORIAL NOTE

Throughout the text of the report footnotes are numbered consecutively as they occur within each section under a sub-heading so that at the commencement of a new subheaded section the numbering reverts to number 1 in each case.

The tables referred to in the text will be found in the volume entitled "Tables and Appendices". Generally speaking the tables and the schedules contained in the text are both in structure and form exactly as entered in evidence, and where errors have been subsequently detected they have been corrected and in some cases amendments have been made for the sake of clarification.

It will be appreciated that the requirement to produce daily copy of the transcripts of evidence has led to some variations from accepted spellings and textual aberrations of other kinds. Wherever possible these have been submitted to the shorthand reporter concerned for reconsideration of his notes and the insertion of errata where necessary in the volumes of evidence. In the few instances where obvious stenographic errors have occurred, and have passed undetected in this process, the necessary changes have been made, although no alteration has been made in the sense of a passage or the language used as transcribed.

Table of Contents

VOLUME 2

Chapter X

	PAGE
THE HUGO OPPENHEIM BANK	679
New Wine for an Old Bottle	679
Great Northern Capital Corporation Hoodwinked	682
Great Northern Capital's \$2,000,000 Atlantic Note	686
Effect of the Sale of Shares on Atlantic's Capacity to Borrow	688
The "Downstream" Borrowing of Lambert & Co.	691
Concealment of Atlantic's Payments to Cimcony Limited	696
Three Versions of the Acquisition of Hugo Oppenheim und Sohn—Tramiel, Morgan and Wirth	698
The Hugo Oppenheim-Cimcony Agreements	701
Artificial Respiration for Hugo Oppenheim und Sohn	707
The German Bank's 120,000 Atlantic Shares	712
Investment by Hugo Oppenheim und Sohn in Shares of Com- modore Business Machines and Analogue Controls	721
Tramiel's Evidence	723
Wolfgang Wirth's Account	727
Disquiet in Berlin	729
Hugo Oppenheim und Sohn and Tramiel Agree to Put the Clock Back	731
Settlement of the Bank's Action against Tramiel	732
Analysis of Financial Information, 1963-65	733
Concluding Reflections	736

Chapter XI

RACAN PHOTO-COPY CORPORATION	738
Elias Yassin Rabbiah	738
The Racan 1015 Dry-Copy Machine	741
A Fugitive from Justice	743
Racan's Sources of Funds	745
Racan's Corporate Records: Falsification of the 1962 Prospectus	750
Complicity of O'Neill Finance Company and Premier Finance Corporation	753
Price, Waterhouse & Co. Deceived: The Duplicate Bank Con- firmation	755

TABLE OF CONTENTS

	PAGE
Rabbiah as a Creditor of Racan	757
S.O.P. Business Machines and Copy Distributors	759
Rabbiah's Expenditures on Research and Development	765
Rabbiah's Receipts Summarized	773
Clues to Identity of the "1015" Machine	775
Involvement of C. P. Morgan	779
Forged Cheques and Spurious Orders on the New York Stock Exchange: June 14, 1965	782
An Explanation of the Mystery	788
 Chapter XII	
THE NEVIL GROUP	791
Neville Levinson	791
Performance of the Nevil Companies	793
Atlantic Loans' Sharp Rise in Face of Heavy Losses in 1964-65	798
Factoring Procedure of Commodore Factors	799
Instalment Loans by Commodore Sales Acceptance and Adelaide Acceptance	802
Levinson's \$40,000 "Investment"	803
Diminished Security for Atlantic Loans and Eventual Loss	809
Woolfrey's Warning to Morgan: The Re-financing Proposal	811
The Assigned Receivables Discrepancy	813
Levinson's Explanation	823
The Commission's Evidence Unanswered	825
A Plethora of Loans	828
 Chapter XIII	
VALLEY FARM AND ENTERPRISES LIMITED	830
Indebtedness of William George Blacklock	830
Blacklock Leasing	832
The Farm	834
The Trio Company	835
"Directors' Loans Payable"	837
Loans to and by Valley Farm and Enterprises	843
Conditional Sales of Cattle	844
Analysis of Atlantic Dealer Reserve for Valley Farm	848
Local Operations of George Blacklock	849
General Spray Service and Phantom Industries Debentures	853
Loans Outstanding at June 30, 1965	855
The Racing Stable	857
Summary of Atlantic's Losses through Valley Farm and Enterprises	858

Chapter XIV

	PAGE
OTHER MAJOR LOANS	860
1	
The General Spray Group	861
Hoge Surrenders Control of General Spray Service Inc.	863
An Arrangement with Creditors: The General Spray Service Debentures	865
Good Money after Bad: The Turf King's Solution	868
American-Marsh Pumps (Canada) Limited	870
American Automation (Canada) Limited	873
General Lawn Spray Limited	874
Summary of Loans and Loss	874
Personal Interest of A. T. Christie	876
2	
Arcan Corporation Limited	882
Arcan Buys Control of Bon Ami Limited	884
Gerald Groship	884
The Struggle for Control between Owen and Morgan	885
Employment of Atlantic Funds by the New Regime	888
Standard International Corporation Intervenes	893
D. P. Owen Resumes Control	898
Estimate of Loss by The Clarkson Company Limited	900
3	
Interim Activities of Gerald Groship	901
Bond & Cosman Limited and Trans Canada Millinery Sales Limited	903
Operations in the Towers Stores	906
Advances by Commodore Sales Acceptance	908
The "Little Scot" Stores	909
Morgan's Plan to "Spread the Liability"	910
Two Special Advances: Bond & Cosman Limited and Premium- wares Limited	916
The Last Word	922
4	
The Symphony Paint Company and Jacroy Canada Limited	922
The Breach with Meckler and Lazar	924
Wagman Assembles the Shares	929
C. P. Morgan's Beneficial Ownership of the Symphony Paint Shares	930
Loans to Symphony Paint and Commodore Factors' Security	932
The Trio and Jacroy Canada Limited	934

TABLE OF CONTENTS

5

	PAGE
Pro Musica Limited	936
Loans and Security of Commodore Sales Acceptance	936
Pearlsound Distributors Limited: Purchase and Sale by N.G.K. Investments	938
Financial Record of Pro Musica	941
Pearlsound's Profits and Pro Musica's Losses on Sale of Inventory	944
Financial Statements of Pearlsound	945
Evidence of Wagman, Lando and Fruitman: The Allowance for Bad Debts	949
The "Guarantee" of Tramiel and Kapp	954
The True State of Pro Musica	957
A Benefit Conferred on Commodore Business Machines	960

Chapter XV

BRITISH MORTGAGE & TRUST COMPANY	963
Background of the Inquiry	963
Expansion under W. P. Gregory	975
The Auditors' Report under the Loan and Trust Corporations Act	978
The Accounting Change in 1964	981
Knowledge of Management and the Auditors	989
The British Mortgage Profile	997
Branch Office Development	999
Changes in Investment Policy	1001
Summary of the Change in Direction	1003
The Atlantic Complex	1005
Section 142 of The Loan and Trust Corporations Act	1008
"Capital and Reserves" Undefined	1010
Breaches of the Limitation on Investments	1011
Securities of the Atlantic Complex: Collateral Loans and Investments	1024
Holdings of Atlantic Complex Securities in 1964 and 1965	1029
The Dispute with the Registrar of Loan and Trust Corporations	1033
The Annual Statement of 1963	1044
The Annual Statement of 1964	1048
The Atlantic Collapse and the Reaction of W. P. Gregory	1062
The Intervention of Harold R. Lawson	1070
The Salvage Operation	1077
The Merger with Victoria and Grey Trust Company	1080

	PAGE
The Run on Deposits and the Ontario Government Guarantee	1085
The Extent of the Loss	1087
Personal Losses of W. P. Gregory	1092
Losses in Estates, Trusts and Agencies	1096
The Liquidation of Holdings of Atlantic Acceptance Stock	1098
The Aurora Leasing Investment	1102
The "Secured Notes" of Aurora Leasing: Carl Solomon as Trustee	1106
The Loan to Aurora Leasing of \$1,200,000	1113
Loans to Aurora Leasing in 1964 and 1965: the Belfield and Tip Top Tailors Mortgages	1116
Final State of Aurora Security Lodged with Solomon	1123
The Mortgage Portfolio	1130
Accounting Treatment of Reserve for Mortgages and Real Estate Held for Sale	1132
The Belfield Mortgages: Roy G. Calladine, L. W. Facey and W. A. Pike	1133
The First Mortgage Loan to Belfield Investments: 70 Belfield Road	1138
50 Belfield Road Limited and 60 Belfield Road Limited	1143
Indus Investments Limited and Surpass Investments Limited	1146
Trans Dallas Investments Limited	1150
Parkay Investments Limited and Trans-Swiss Investments Limited	1151
Hi-Homes Limited—Flomar Securities Limited	1154
The Bankruptcy of Belfield Investments: Comments of the Trustee and Auditors	1155
The Participation of Facey and Pike and the Extent of Gregory's Knowledge	1157
The 1966 Amendment to Section 142 of The Loan and Trust Corporations Act	1170
The I.G.A. Stores—West Lorne and Owen Sound	1171
Yonge-Eglinton Building Limited	1192
The Dale Estate Transaction	1197
Severn Investment Company Limited	1207
Conarm Developments Limited	1215
C. P. Morgan as Trustee for British Mortgage & Trust Company	1220
M. Della Scala and the Trustee	1225
Aurora Leasing Corporation: Loan to W. P. Gregory	1227
W. P. Gregory and his Board	1232
The President's Files	1246
Concluding Reflections	1260

CHAPTER X

The Hugo Oppenheim Bank

New Wine for an Old Bottle

Hugo Oppenheim und Sohn Nachfolger Berliner Privatbank, Aktiengesellschaft, to give it its full name, has been referred to on many previous occasions in this report. Its rôle in the affairs of Atlantic Acceptance Corporation must be examined in some detail. This was played at a critical time in the history of Atlantic Acceptance Corporation and had a particular bearing on the company's ability to increase its borrowings, particularly by the issue of senior secured notes in a manner more fully dealt with in Chapter XVI. The documents in the possession of the Commission were examined by Mr. R. E. Lord, C.A. of Clarkson, Gordon & Co., who testified on October 20 and 21, 1966,¹ and Mr. B. Wolfman, C.A. of P. S. Ross & Partners gave evidence about the part played by the Bank in the purchase, with Great Northern Capital Corporation, of 240,000 shares of the common stock of Atlantic in the autumn of 1964.²

The Bank was incorporated in 1951 and was known as the Jewish Bank until 1962 or thereabouts, when it acquired the right to use the name Hugo Oppenheim und Sohn. Its main premises were at No. 32 Kurfuerstendamm in West Berlin and at the time material to this inquiry it had branches in Frankfurt-am-Main and Hamburg. The Bank's original function, as it would appear, was to disburse payments made by the government of the Federal Republic of Germany to those Jewish firms and individuals who had been despoiled of their property under the National Socialist regime and were considered to be entitled to reparation. By 1964 this function had virtually ceased and it was carrying on business in a small and unprofitable way with a total capitalization of D.M. 1,500,000. This must be considered small even in a community where branch banking on the scale practised in Canada and Britain is unknown. The situation was about to change.

¹Evidence Volumes 73-4.

²Evidence Volume 69.

On September 30, 1964 the shareholders passed a resolution increasing the capital to D.M. 2,000,000 by issuing 500 new shares with a value of D.M. 1,000 each. These shares were to receive dividends from an effective date of October 1. At the same meeting a further increase of capital amounting to D.M. 5,000,000 was authorized, consisting of an issue of 2,500 new shares with the same par value of D.M. 1,000 and 25,000 shares with a par value of D.M. 100, which were to participate in profits as of January 1, 1965. Then at a subsequent meeting on October 29, a further 1,500 shares with a par value of D.M. 1,000 and 15,000 with that of D.M. 100 were authorized; as a result the authorized capital stood at D.M. 10,000,000. Although generally speaking, the shareholder of a German company has the right to acquire shares of a new issue arising from increase in capital on a *pro rata* basis according to the extent of his holdings, in the case of the first two increases described this right was waived, and the existing shareholders were barred from participating to enable "a new shareholder", who previously had held no shares, to subscribe for them in their entirety. All of these were subscribed for by September 30 and, according to the auditor's report for the year 1964 made by Arthur Andersen & Co.,³ the shareholders of the Bank as at December 31, 1964, with the amounts of their holdings, were as follows:

J. Tramiel	D.M. 8,127,500
Baron von Rheden-Rheden	D.M. 1,000,000
Albert Neumann	D.M. 850,000
Hans Seligmann	D.M. 22,500

With effect from September 30 Jack Tramiel became chairman of the board of directors and von Rheden deputy chairman.

How this came about was described to the Commission by Tramiel⁴ and Morgan⁵ in their testimony given on oath, and in terms not always easy to reconcile. In addition Wolfgang Wirth, general manager of Hugo Oppenheim und Sohn during the period of Tramiel's control of its operations and thereafter, and Baron von Rheden were both interviewed in Germany in August of 1966, as described.⁶ From this evidence it appears that the idea of buying a controlling interest in a German bank had first occurred to Tramiel in the early summer of 1964, as a means of financing the Willy Feiler operation of Commodore Business Machines at a lower rate of interest than that company was paying Atlantic Acceptance in Canada. According to Tramiel, the proposition was discussed with Morgan at this stage and the latter agreed that cheaper money was desirable from any source. Tramiel

³Exhibit 3296.

⁴Evidence Volume 86.

⁵Evidence Volume 25.

⁶Commissioner's notes on conversations in Germany.

employed a Dr. Scholze and his first attempt to buy an interest in a bank, for which he borrowed \$100,000 from friends for the purposes of making a deposit, proved to be abortive and the money was returned. During these negotiations he met Wolfgang Wirth, an employee of the bank in question. Wirth knew of the situation of Hugo Oppenheim und Sohn which had suffered losses between 1962 and 1964 and the capital of which was impaired to the extent of D.M. 800,000. It was consequently available for purchase and Tramiel was so advised. Morgan, however, in a passage of his evidence which must be quoted, said that he knew nothing about the transaction until Tramiel appeared in his office one day and showed him a card indicating that he, Tramiel, was already the Bank's presiding officer.

A decision as to which of the two was telling the truth in this matter, or, to put it more accurately which version is to be preferred, must be deferred until the method of financing the purchase of upwards of 80% of the stock of Hugo Oppenheim und Sohn for registration in the name of Jack Tramiel has been studied. The value of Tramiel's shares in Canadian funds was \$2,198,603 and an additional \$54,795 was paid as a tax on the issue of shares out of the Bank's treasury at a rate of approximately 4%. The total cost of acquiring these shares, together with additional small charges, was therefore \$2,254,200 in Canadian funds. On November 10, 1964 Atlantic Acceptance issued its cheque No. 79997⁷ to Commodore Sales Acceptance in the amount of \$2,750,000 and on the same day cheque No. 6442 of Commodore Sales Acceptance was issued to Aurora Leasing Corporation in the same amount.⁸ No security was taken from Aurora in respect of this loan and none existed, except the doubtful assignment of book debts of December 21, 1960 drawn and executed by Carl Solomon and signed as well by Harry Wagman on behalf of Aurora when the affidavit of *bona fides* was also made by Solomon on behalf of the assignor. Also on November 10 Aurora cabled the sum of \$2,075,000 to Hugo Oppenheim und Sohn, the cable transfer being marked "payment to Jack Tramiel". The disbursement journal of Aurora⁹ records on page D-92 payment of this sum under the notation "Oppenheim cable Evermac", and on the same day it also recorded a cable transfer to Cimcony Limited of \$537,673.75. Then on the Aurora notes receivable ledger appears a loan to Evermac Office Equipment Company Limited of \$2,075,027.55, the excess over \$2,075,000 consisting of \$25 in bank charges and \$2.55 for costs of the cable. The entry is dated November 10, 1964 and the loan was expressed to be at 9% interest, but again no security was taken; nor does there appear to be any evidence of debt from Evermac in the

⁷Exhibit 3297.

⁸Exhibit 3298.

⁹Exhibit 929.

form of a promissory note, although the Evermac books¹⁰ record the borrowing for the purpose of investing in the shares of Hugo Oppenheim und Sohn with an effective date of November 12. The balance of the amount required to purchase Tramiel's shares in the Berlin bank was received from Commodore Sales Acceptance by Trans Commercial Acceptance in two amounts; the first was \$135,500 recorded on the books of Trans Commercial Acceptance as received on October 13 and \$43,000 on November 2.¹¹ This money was lent by Trans Commercial Acceptance initially as if it were a loan to Tramiel, but a letter to Evermac Office Equipment dated December 31, 1964—headed, be it said, "Trans Commercial Acceptance Ltd. c/o Solomon & Singer, 44 King Street West, Toronto 1"—described the two advances to Tramiel as being \$135,500 made on October 13 and "a further \$43,700 on December 9". It proceeded: "Mr. Tramiel had now advised us that he had been acting as your agent, and the advances should have been charged to your account."¹² Thereafter the letter says that Tramiel had paid interest charges of \$2,182.84 and requested that Evermac reimburse him accordingly. This was replied to by Evermac in a letter from 946 Warden Avenue in Scarborough, Ontario, the address of Commodore Business Machines, acknowledging Tramiel's claim and signed by Manfred Kapp.¹³

These funds were transmitted to Germany by two cheques drawn on Tramiel's account at the Mercantile Bank of Canada, the first being dated September 30, no doubt to comply with the subscription date for the Hugo Oppenheim shares, but not paid by the Mercantile Bank until October 13, in the amount of \$135,501¹⁴ and a second cheque dated December 1 was paid on December 9 for \$43,700.¹⁵ Although Jack Tramiel received over 80% of the issued capital stock of Hugo Oppenheim und Sohn for these amounts and the definitive certificates were mailed to the American Express Company in Frankfurt on March 2, 1965, none of the shares were pledged in respect of these loans.

Great Northern Capital Corporation Hoodwinked

An explanation for this heavy investment in an institution of a foreign country, with no security required for the loans from Atlantic Acceptance which supplied all the money to buy Tramiel's dominant interest in it, may be found in the minutes of a meeting of the board of directors of Atlantic dated September 24, 1964.¹ At the conclusion of the minutes occurs the following passage:

¹⁰Exhibit 2243.

¹¹Exhibit 2241.

¹²Exhibit 3300.

¹³Exhibit 3301.

¹⁴Exhibit 3302.

¹⁵Exhibit 3305.

¹Exhibit 26.

"PROPOSED SALES OF COMMON STOCK, SENIOR NOTES AND JUNIOR SUBORDINATED NOTES"

The Chairman stated that the Company had been negotiating through Cimcony Limited for the sale to certain European institutional investors of 120,000 common shares of the Company at \$18.00 (Canadian) per share, \$3,000,000 (U.S.) aggregate principal amount of junior subordinated notes and \$17,500,000 (U.S.) aggregate principal amount of senior notes of the Company.

He stated that Great Northern Capital Corporation Limited, the principal owner of in excess of 50% of the Company's outstanding common shares, advised the Company that if the sale of such 120,000 common shares was completed on the foregoing basis that it desired to purchase an additional 120,000 common shares on the same basis in order to maintain its equity position within the Company.

The officers of the Company were authorized to continue these negotiations and to make arrangements for the necessary clearances with the Ontario Securities Commission and the Toronto Stock Exchange."

This followed a decision taken by the board to increase the maximum aggregate consideration for which the 1,000,000 common shares of the company might be issued from \$14,000,000 to \$16,500,000, and to pay the required fee to the Provincial Secretary whose certificate as to payment was issued on October 7.² This action had been prompted by receipt of the following letter from Cimcony Limited in Nassau, signed by Carrol M. Shanks as chairman and dated September 11, 1964:³

"This is to advise you that we hereby commit to take in a 'package' only 120,000 shares of the Common Stock of your Corporation, together with 3,000,000 U.S. Junior Subordinated Notes of your Corporation—said Notes to be for a term of 10 to 20 years at a rate not to exceed 6½% U.S. .

The purchase price of this 'package' is \$4,900,000 (U.S.) net to you.

In addition, we are to receive a commitment from your Corporation advising us to sell for your account 17,500,000 Senior Secured Notes for a similar term at a rate not to exceed 6% U.S. .

A placing fee is to be paid by you to us for these Senior Secured Notes and will not exceed 1½% of the face amount thereof.

We agree to use wherever possible Messrs. Sullivan & Cromwell, New York, as the purchaser's counsel, at your cost and expense.

This entire transaction will originate and be handled by our office here, together with co-managers of the distributing syndicate who also will be domiciled outside of Canada and continental U.S.A."

No commission was suggested for the selling of the shares and notes, although the purchase price of \$4,900,000 would yield a profit of \$100,000 if the shares sold at \$18 and notes at par, equivalent to a commission of 2%.

²Exhibit 13.

³Exhibit 3287.

Such a communication from Cimcony Limited, which had been forecast at a meeting of May 27 between Weinrott and Morgan⁴ where it was agreed that Atlantic would appoint it as its sole fiscal agent, a company without experience or reputation and of which Morgan as sole owner of Mortgage Trust & Savings Corporation (Bahamas) Limited owned 25%, produced the expected reaction from Great Northern Capital Corporation. This company which, as has been seen, represented the major investment of Lambert & Co. of New York, held, at the time of the Cimcony Limited offer somewhat over 51% of the common stock of Atlantic Acceptance. On September 29 the minutes of a meeting of its directors⁵ record the attendance of C. P. Morgan and his report to the Great Northern directors that he was negotiating "for additional financing for Atlantic which will involve the issuance of 120,000 common shares of Atlantic on the understanding that this Company, in order to maintain its controlling position, be given the opportunity to purchase a like number of shares." The board thereupon resolved, after Morgan had left the meeting, to authorize the purchase of 120,000 common shares of Atlantic at a price of \$18 for a total consideration of \$2,160,000. Not only was control of Atlantic by Great Northern involved here; by generally accepted accounting principles if a company holds more than 50% of the voting stock of another it can regard it as a subsidiary and consolidate the total earnings of the subsidiary with its own in proportion to the amount of its interest, but if that interest should fall below 50% it can only take up the amount distributed as dividends. To illustrate the position here in 1964, Atlantic earned \$1.10 per common share or, as was reported, a total of \$776,038, whereas the amount paid out in dividends in respect of common shares was only \$403,775. To Great Northern the preservation of its greater than 50% control meant the difference between taking up income of \$382,000, which was its proportion of Atlantic earnings, and some \$234,000 which would have been its proportion of the dividends paid. The letter written to Atlantic Acceptance on September 30, signed for Great Northern by Anthony C. Rooney and accepted for Atlantic by C. P. Morgan, was as follows:⁶

"Dear Sirs:

You, Atlantic Acceptance Corporation Limited ('Atlantic'), have advised us, Great Northern Capital Corporation Limited ('Great Northern'), that Atlantic has negotiated the sale to E. D. Sassoons Bank of Nassau of 120,000 common shares without par value of Atlantic and \$3,000,000 (U.S.) of junior subordinated notes of Atlantic to be for a term of from 10 to 20 years at an interest rate not to exceed 6½%. Atlantic has further advised Great Northern that the said sale of the 120,000

⁴Exhibit 1976.

⁵Exhibit 119.

⁶Exhibit 3288.

common shares of Atlantic is to be at the price of \$18.00 (Canadian) per share, that the sale of such notes is to be at a price which after payment of financial advisory fees will produce \$2,900,000 (U.S.) to Atlantic and that the closing of these sales will be completed prior to December 31, 1964. Great Northern understands that Atlantic is prepared to sell to Great Northern 120,000 common shares without par value of Atlantic at the price of \$18.00 (Canadian) per share.

This letter is written to confirm to Atlantic that Great Northern is prepared to purchase 120,000 of such common shares at the price of \$18.00 (Canadian) per share on or prior to November 30, 1964, subject to the fulfilment of the following conditions, any or all of which may be waived by Great Northern:

1. Atlantic shall satisfy Great Northern prior to the completion of the sale that the sale of the common shares and junior subordinated notes to E. D. Sassoons Bank mentioned above has either been completed or has been firmly committed for on terms not less advantageous to Atlantic than set forth above.

2. The sale of such shares by Atlantic to Great Northern shall not contravene the provisions of the Ontario Securities Act and evidence to this effect satisfactory to Great Northern shall be furnished by Atlantic.

3. The sale of such shares by Atlantic to Great Northern shall have been approved by the Toronto Stock Exchange and such shares shall have been accepted for listing on such Exchange.

4. Great Northern shall receive an opinion satisfactory to it from Messrs. Osler, Hoskin & Harcourt as to the valid authorization and issue to Great Northern by Atlantic of such 120,000 common shares of Atlantic as fully paid and non-assessable.

The closing of the said sale of such shares to Great Northern shall take place on November 30, 1964, or on such earlier date as Great Northern and Atlantic shall mutually agree upon.

If the foregoing is in accordance with your understanding of our agreement would you please so confirm by signing and returning to us the copy of this letter which is enclosed.

Yours very truly,
GREAT NORTHERN CAPITAL CORPORATION
LIMITED

'Anthony C. Rooney'
Vice-President.

We confirm that the foregoing correctly sets forth the agreement reached between us.

Dated: September 30, 1964.

ATLANTIC ACCEPTANCE CORPORATION LIMITED

'C. P. Morgan'
President."

All but the first of the four enumerated conditions were satisfied and, in so far as the first is concerned, the E. D. Sassoon Bank bought no shares and no junior subordinated notes were sold. The approval of the Toronto Stock Exchange was given in a letter dated September 17, 1964,⁷ addressed to A. L. Beattie, Q.C. of Osler, Hoskin & Harcourt, and in this the falsehood about the sale to Sassoon's is referred to as a sale of 120,000 common shares at \$18 per share to "not in excess of five substantial European insurance companies" of which the E. D. Sassoon Bank of Nassau was to be the nominee. At the same time as this sale was exempted from the requirement of filing a statement with the exchange a similar exemption was given to the sale of 120,000 common shares at the same price to Great Northern Capital Corporation. Particulars of these insurance companies were requested but no answer was ever given; instead on November 24, Osler, Hoskin & Harcourt wrote to the Toronto Stock Exchange,⁸ advising it of the sale of shares to Hugo Oppenheim und Sohn and Great Northern Capital Corporation, saying that the German bank had bought the shares for its own account for investment purposes and enclosing a copy of a letter from the Ontario Securities Commission approving of the issue of the 240,000 shares without requiring the filing of a prospectus.

Great Northern Capital's \$2,000,000 Atlantic Note

Prior to the issue of the common shares a short-term note of Atlantic Acceptance, No. STN-2416,¹ was bought by Great Northern Capital Corporation for \$2,000,000. Although this note was outstanding at the close of business on September 30 for value received, it was not included in the quarterly statement of that date, which, under the deed of trust securing the note issues, the company was bound to make to its noteholders stating the amount of short-term debt outstanding. At September 30 the quarterly statement reported short-term notes outstanding of \$43,050,000 in Canadian funds.² Two documents were examined, journal voucher No. 302³ and a work sheet entitled "Statement Entries", dated September 30, which were journal entries made for the purpose of treating transactions in the Atlantic statement not reported permanently in the books.⁴ It is a common practice to do this in relation to minor accruals and prepayments, but unusual in dealing with liabilities and share equity. Journal voucher No. 302 records a subscription for stock in the amount of \$4,320,000. The statement entry then reverses notes outstanding by debiting short-term notes \$2,000,000 and shows the \$2,000,000 as payment on the subscription for capital stock of the company, so that this sum does not show as an outstanding

⁷Exhibit 3289.

⁸Exhibit 3290.

¹Exhibit 3291.

²Exhibit 95.

³Exhibit 3292.

⁴Exhibit 3293.

liability on the quarterly statement at September 30. On the other hand there is a \$2,000,000 credit against subscriptions receivable and this is reflected in the equity section of the balance sheet. The effect of this was that Atlantic Acceptance reported outstanding notes in an amount of \$2,000,000 less than the truth required, and shares outstanding to the value of \$2,000,000 more than was in fact the case on September 30, 1964.

That this was no mere inadvertence, but was deliberately done, is shown by a letter dated October 1, 1964 from D. N. MacGowan at the executive offices of Atlantic in Toronto, to Donovan R. Lytle at the head office in Oakville⁵ in which the writer says:

"Please be advised that as at September 30th, 1964, Short Term Authenticated Notes outstanding, including bank loan of \$1,250,000.00 was:

Canadian	\$31,990,755.76
United States	\$13,253,000.00
	<u>\$45,243,755.76</u>

Medium Term Authenticated

Notes Outstanding was \$ 5,000,000.00 U.S."

To make this statement comparable with the quarterly report sent to the noteholders the amount shown in United States funds must be converted to Canadian funds and the total figure reduced by the amount of the minimum bank loan provided for under the trust deed which, although represented by a note for \$1,250,000 held by the Toronto-Dominion Bank, was reported separately as a bank loan in the quarterly report. The result was that outstanding short-term notes as reported by this internal memorandum, after making these adjustments, amounted to \$45,050,000 instead of \$43,050,000 as shown in the quarterly report. It will be seen later that a correct report of the amount of outstanding short-term notes might have had important consequences. On October 28 C. P. Morgan wrote to Alan T. Christie, president of Great Northern Capital, advising him that Hugo Oppenheim und Sohn had telegraphed its commitment to purchase 120,000 treasury shares of Atlantic Acceptance on the previous day and attaching a copy of the telegram⁶ which read:

"HEREWITH IS OUR COMMITMENT TO PURCHASE 120,000 (ONE HUNDRED AND TWENTY THOUSAND) TREASURY SHARES COMMON STOCK YOUR COMPANY FOR OUR INVESTMENT ACCOUNT CLOSING TO TAKE PLACE 11 A.M. NASSAU B.W.I. TIME AT THE OFFICES OF CIMCONY LTD IN NASSAU ON NOVEMBER 24th 1964. OUR REPRESENTATIVE WILL BE VICE-CHAIRMAN OF BOARD BARON VON RHEDEN AND DIRECTOR WIRTH CASH OF TWO MILLION ONE HUNDRED AND SIXTY THOUSAND CANADIAN AGAINST DELIVERY OF SHARES."

⁵Exhibit 3294.

⁶Exhibit 3295.

At this time, as already noted, Hugo Oppenheim und Sohn was not in funds to complete the transaction and was not to be so until November 10; moreover, as will appear, the statement that the purchase was for its "investment account", made to qualify it as an exempt transaction, was false.

Effect of the Sale of Shares on Atlantic's Capacity to Borrow

An examination of the various trust deeds executed by Atlantic Acceptance Corporation in favour of the Montreal Trust Company and the limitations that these imposed upon the finance company's borrowings will be found in Chapter XVI, but a brief comment to mark the effect of the transactions with Hugo Oppenheim und Sohn and Great Northern Capital will not be out of place here. As a result of the loan made to Commodore Sales Acceptance, and thence to Aurora Leasing, Atlantic Acceptance obtained a receivable from the latter in the amount of \$2,750,000 available to be lodged with the trustee as security. By November 25, 1964 Atlantic had recovered its money but in an altered character, since it now consisted of a subscription for equity, and its power of leverage had been greatly increased. There were three tiers of borrowing to which Atlantic could resort secured by trust indentures; one for senior notes, the second for subordinated notes which ranked behind the senior notes, and the third for junior subordinated notes which in turn ranked behind the subordinated notes. There were limitations on the amount of money which the company could borrow secured by these different classes of notes, expressed in relation to the shareholders' equity or, as the indentures say, the consolidated net worth. The company was permitted under the trust deed securing the senior notes to issue them in an amount equivalent to 350% of the total of the consolidated net worth and all the subordinated notes which had been issued. In short, and assuming that the consolidated net worth can be equated to shareholders' equity, the company was authorized to have outstanding in senior notes three-and-a-half times the amount by which the equity had been increased, or in other words the value of the additional shares sold. It could also issue senior notes in the amount of three-and-a-half times any sum borrowed by the company and secured only by a subordinated note. The original trust deeds for subordinated notes¹ and junior subordinated notes² provided that the company could issue subordinated notes to the extent of 150% of the consolidated net worth, so that if it sold \$2,000,000 worth of common shares it became entitled to issue 150% of that amount, or \$3,000,000 worth of subordinated notes. The original trust deed securing senior notes³ provided in its turn that the company could borrow by issuing

¹Exhibit 780.

²Exhibit 3310.

³Exhibit 47.

senior notes for three-and-a-half times the aggregate amount of the subordinated notes plus the equity, so that if it could sell \$2,000,000 worth of common stock it could issue \$3,000,000 worth of subordinated notes, and the \$2,000,000 worth of common stock added to the \$3,000,000 worth of subordinated notes producing a total of \$5,000,000, additional senior debt would be authorized in the amount of \$17,500,000. In other words, increased equity of \$2,000,000 would support borrowings of over ten times that amount under the terms of the various trust deeds.

The evidence thus far deals only with the financing of the purchase of \$2,160,000 worth of the company's own stock by a loan of its own money which reached Hugo Oppenheim und Sohn by a circuitous and carefully concealed route, putting it in the position, by an infusion of capital, to complete the share transaction; no subordinated notes were involved. Taking the purchase price of the 120,000 shares at a round figure of \$2,000,000, Atlantic immediately became entitled to have an additional \$7,000,000 worth of senior secured notes outstanding. Thus, when on September 30, 1964 the company treated the \$2,000,000 paid by Great Northern Capital for its senior short-term note as a subscription for shares, it was ostensibly entitled at that time to borrow, by selling senior notes, \$7,000,000 more than would have been the case had the transaction been correctly and honestly reported. Alternatively, if Atlantic had been in breach of the maximum borrowing ratios of the trust deed on that date, the breach would have been remedied, or partially remedied depending upon the extent to which it was in default, if it had an additional \$2,000,000 in equity to add to its borrowing base. I accept the evidence of Alan Christie that this manoeuvre was never brought to his attention, and his view that a serious impropriety had been committed.

The letter of September 11, 1964 from Cimcony Limited to Atlantic⁴ quoted amounts in the same proportions as those allowed under the trust deed and referred to total financing of \$22,500,000, but since the subscription of Hugo Oppenheim und Sohn of \$2,000,000 (leaving out for the moment the additional \$160,000 which was actually subscribed) was not in fact new money, its effect was to permit additional financing in an aggregate amount of \$20,500,000. This figure would be subject also to a deduction of \$362,000 for commissions payable to Cimcony Limited, if it had sold all the notes which it was supposed to sell in the "package". The Great Northern Capital subscription of \$2,160,000, or \$2,000,000 in U.S. funds, was a genuine addition to the equity so that the total increase in fresh money available to Atlantic, if all the permitted borrowing had been undertaken, was \$43,000,000 in U.S. funds. At September 30, 1964 the senior debt, less accrued interest, was \$89,610,030, the subordinated debt, after deduction of \$1,080,000 represented by the outstanding amount of the Cimcony of Canada notes,

⁴Exhibit 3287.

was \$13,346,889 and the company's consolidated net worth, as defined in the deed of trust, was \$11,804,478, after adjustment made necessary by the evidently deliberate mis-statement of the quarterly report, reducing equity by \$2,000,000 and increasing senior debt outstanding by the same amount. If the figures in the quarterly statement had been properly given, they would have shown that the senior debt exceeded 350% of subordinated debt plus consolidated net worth by upwards of \$9,000,000, and Atlantic's default would have been clearly revealed.⁵ As it was stated, however, the ratio was 298% or well within the permitted maximum. Between September 30, 1964 and March 31, 1965, the latter date being that of the last quarterly report made to the note-holders before default,⁶ senior debt had increased to \$103,995,000, subordinated debt to \$16,786,000 and shareholders' equity on a consolidated basis to approximately \$16,080,000. Thus the senior debt was only 317% of the subordinated debt plus equity, but if the additional \$4,000,000 worth of equity represented by the Hugo Oppenheim und Sohn and Great Northern Capital subscriptions had not transpired, senior debt as at March 31, 1965 would have amounted to 360%, thus illustrating the extent to which subsequent borrowings were sustained by these transactions.

The question arises as to who bore the loss, if any, occasioned by this gravely improper transaction by which 120,000 common shares of Atlantic Acceptance were ostensibly bought by Hugo Oppenheim und Sohn. Of the loan to Evermac Office Equipment attributable, be it said, solely to accounting entries and a declaration of trust in favour of that company made by Jack Tramiel as late as February 16, 1965 as the original typing shows, but with the name of the beneficiary inserted in different typing and perhaps much later,⁷ the trustee expects to recover little or nothing. It cannot be said that Atlantic Acceptance itself lost this money, because, after the circulation already described, it came back to the company in a matter of two weeks. No doubt the effect of the company issuing 120,000 shares with no genuine accretion to capital would have diluted the equity of the other shareholders had the shares continued to have any value beyond the immediate aftermath of the company's default. But the purchasers of Atlantic notes after the date of the transaction would be seriously affected, since they relied on an alleged increase of shareholders' equity lying behind their notes. In addition, Great Northern Capital Corporation suffered a substantial loss as a result of being induced by false representations to invest a further \$2,000,000 in Atlantic common stock which, apart from the loss suffered in June 1965, led to a loss of liquidity and the necessity of making further borrowings at a critical period.

⁵Exhibit 3468.

⁶Exhibit 98.

⁷Exhibit 989.1.

The "Downstream" Borrowing of Lambert & Co.

The 120,000 shares for which Great Northern Capital had agreed to subscribe were paid for by the redemption on November 24 of the \$2,000,000 short-term note and an additional cheque for \$160,000 on the same day.¹ That Great Northern agreed to this substitution is indicated by a letter from the secretary-treasurer, A. R. Voelker, enclosing the cheque and acknowledging receipt of the shares at the same time. In this autumn of 1964 Lambert & Co. needed money to settle their accounts with Williams Brothers who had participated with them as shareholders in Great Northern Capital and who, as a result of a division of assets which is not material to this report, were then in the process of yielding complete control of the company to the New York firm. The following letter, a copy of which was found in C. P. Morgan's office, was dated December 17, 1964, addressed to the Bank of Montreal Agency in New York and initialled for Atlantic Acceptance Corporation in Morgan's hand:²

"We understand that Lambert & Co. have applied to you for a loan of \$1,000,000 (U.S.) to be evidenced by a note of Lambert & Co. to be dated December , 1964. We further understand that this note together with an existing note of Lambert & Co. for \$1,000,000 (U.S.) will be secured by a pledge to you of 787,000 shares in the capital stock of Camerina Petroleum Corporation.

In consideration of your making the said loan of \$1,000,000 (U.S.) to Lambert & Co. on their note dated December , 1964, we hereby irrevocably undertake to cause such note to be purchased from you at par plus accrued interest by a United States lending institution on or before January 15, 1965, and we further irrevocably undertake that failing such purchase, we will ourselves purchase the said note from you at par plus accrued interest to the date of our purchase."

The Bank of Montreal proceeded with this loan on the strength of the Atlantic guarantee and a telegram dated December 17, 1964, authorizing a further advance of \$1,000,000 in U.S. funds to Lambert & Co., refers to Atlantic as its wholly-owned subsidiary and concludes:

"Atlantic Acceptance Corporation is favourably reported upon by our Toronto office and the Toronto-Dominion Bank Toronto where the account is carried."

It may be noticed in passing that the guarantee given by Atlantic was not referred to as a contingent liability in its annual statement as at December 31, 1964. As it turned out the whole \$2,000,000 owed to the bank by Lambert & Co. was paid on January 18, 1965 with Atlantic money which began as a loan of \$2,200,000 in Canadian funds, made by cheque dated January 18, from Atlantic to Commodore Factors Limited.³

¹Exhibit 3324.

²Exhibit 3325.

³Exhibit 3327.

Commodore Factors on the same day issued a cheque for \$2,148,125 in Canadian funds, payable to the Bank of Nova Scotia and marked on the back: "re Motion Picture Security Corporation."⁴ Again on the same day, Fred B. Adair Jr., on behalf of Motion Picture Security Corporation, wrote to A. G. Woolfrey at Commodore Factors⁵ authorizing him to act on behalf of the company in making a loan of \$2,000,000 in U.S. funds to Cushing & Co. which, as already noted, was a name used by Lambert & Co. A collateral agreement between Motion Picture Security and Cushing & Co., also dated January 18,⁶ provides for a loan in that amount due September 30, 1965, to be secured by a promissory note bearing interest at 8½ % per annum, and the pledge of 787,000 shares of Camerina Petroleum Corporation. According to the notes receivable ledger of Commodore Factors, Motion Picture Security was paying only 7½ % by way of interest,⁷ and it will be recalled that this was a company in which Mildred L. Morgan held a two-fifths interest and was half-owned by Adair who was also president of Manhattan Sound Corporation, in which C. P. Morgan, through her and Donald W. Reid, controlled somewhat more than 25% of the common stock. On this occasion the collateral agreement between Motion Picture Security and Cushing & Co. was signed for the former by A. G. Woolfrey. This, then, was the "American lending institution" which Atlantic Acceptance produced in accordance with the terms of its letter to the New York Agency of the Bank of Montreal. It in turn pledged the Camerina Petroleum shares with Commodore Factors and delivered forty promissory notes for \$50,000 each which Commodore Factors deposited with the Montreal Trust Company as security under the trust deed.

Faced with the apparent similarity of this transaction with that concluded between Atlantic Acceptance and Hugo Oppenheim und Sohn, the Commission made further inquiries as to the origin of this loan from sources which included C. P. Morgan and two Lambert partners, Alan T. Christie and Gay V. Land. The shares of Camerina Petroleum were used as security for the first loan made to Cushing & Co. with Atlantic money by Aurora Leasing Corporation on March 19, 1963 in the amount of \$1,350,000. The draft agreement in connection with this loan⁸ provided that the loan was to be made for eighteen months, falling due on September 20, 1965; but, according to Aurora's loan records,⁹ it was repaid on September 1, and Cushing & Co. borrowed \$1,000,000 in U.S. funds from the Bank of Montreal Agency on the same security in order to do so. Aurora in turn repaid Atlantic; then on December 18, one day after the guarantee made by Atlantic to the

⁴Exhibit 3328.

⁵Exhibit 3329.

⁶Exhibit 3330.

⁷Exhibit 3331.

⁸Exhibit 3333.

⁹Exhibit 929.

Bank of Montreal in connection with its loan to Cushing & Co., Great Northern Capital Corporation lent Atlantic \$1,000,000, taking a senior note for that amount; so that on January 18, 1965, thirty days after the Great Northern Capital loan had been made, Atlantic had \$1,000,000 in U.S. funds lent by Great Northern Capital and \$1,000,000 in U.S. funds repaid by Aurora, previously lent by it through Aurora to Cushing & Co. When on January 18, 1965 Atlantic made the loan to Cushing & Co. through Motion Picture Security of \$2,000,000 in U.S. funds, the substance of the transaction was that Great Northern Capital had lent \$1,000,000 of its own money to Atlantic and Atlantic \$1,000,000 to Lambert & Co.

Christie's observations on the loan through Motion Picture Security betray some uneasiness which existed at the time among the Lambert partners, and perhaps an unwillingness to examine the source of their money too closely:¹⁰

"Q. In January, 1965, according to the evidence before the Commission, a loan was made in the sum of \$2,000,000 U.S. funds, to one of the Lambert nominee names, and I believe it was Cushing?

A. Yes, I think you are right.

Q. Recorded as having been made by Motion Picture Securities, which money originated in the Atlantic group and came from Commodore Factors. What knowledge did you then have about this transaction, and what transpired?

A. That deal arose—that I discussed personally—I called Mr. Morgan to ask if he by chance knew of an American lender who, thinking of a finance company, with whom he might have reciprocity, or something of that sort, who would lend against the Camerina shares. We did not want to borrow them in Canada, and the important reason of this is that we, rather than the question of withholding tax which wasn't payment of interest, which was not beneficial to anyone, and he said he would see what he could do. Then I passed it over to Mr. Land, who was president of Camerina and was looking after that part. Now, it appears that, to be fair to Mr. Morgan, he may have thought that I was alluding to his doing it when it was arranged and we had to arrange it fairly quickly, because, as you already know, I believe those shares were already pledged with one of the banks who would not, at normal banking rates, have loaned as much as was loaned against them, although it was a perfectly sound loan we were satisfied.

THE COMMISSIONER: That was the Bank of Montreal?

A. That was the Bank of Montreal agency, yes—and had already started to use the additional money we borrowed to spend or use. We put it in as time deposits which was against an obligation of ours, and we felt this was pretty secure money we were taking, and it was costing us something to do it, but it was part of our arrangement with the other bank. But it became evident, I think probably subconsciously, if

¹⁰Evidence Volume 91, pp. 12403-7.

not consciously, to all of us, that it was from Atlantic. This was not our desire but it did not make us feel that this was a bad procedure. It was well secured, we didn't feel we were doing anything improper, and the reason that we—that I began to feel it was so, is that when Mr. Morgan was making the arrangements on it it didn't seem to me as though it was what I had originally thought and we were not happy about it but satisfied the loan was good, and it was good, and I wish all of Atlantic had been as good.

Q. When did you first hear of Motion Picture Securities?

A. When he gave the instructions to Mr. Land that this was where it was to go. We had never heard of the company, as a matter of fact.

Q. When did you personally first hear?

A. When he—when Mr. Land told us that was the arrangement and someone in our organization started to make some inquiries about what this organization was before the deal had started and we had the commitment and the thing that worried me then was that this had been started but we couldn't stop it.

Q. The cheque was in fact brought to New York, as the Commission is informed, by one Woolfrey, and it was a Commodore Factors cheque which was payable to Cushing, you would agree?

A. It was a Factors' cheque, was it?

Q. Evidently, which is simply a bookkeeping entry?

A. Well, where did it go? Who was it given to? It was probably given to a bank?

Q. It may be.

A. So that we would never have seen that.

Q. What is your own recollection of the matter?

A. I had no knowledge this happened. This certainly would have been indicative, but what probably happened was that we gave instructions to the bank and I suppose it would have been the Bank of Montreal, to deliver the shares against the payment of the cheque, so that we would never see the cheque, at least this would be my belief. These things become very important and they are magnified now, which were almost routine at that time. We undertook to maintain a collateral value also to that loan."

When Gay V. Land, another Lambert partner, was examined by officers of the Securities and Exchange Commission in New York on October 21, 1965, he said that in January Lambert & Co. were short of cash and that he personally had discussed with C. P. Morgan the possibility of raising it. He continued, under examination by Mr. Adolph:¹¹

"A. To go back to my previous testimony—I said we had made a public offer to buy out all of the shares of Great Northern Capital for \$11 a share, which amounted to very, very substantial commitment on our part, which required both long-term and short-term financing

¹¹Exhibit 2474, pp. 20-3.

on the part of Lambert and Company. We had been unable to unwind the transaction within the period of time that the short-term money was borrowed for, and therefore, in December or January, some time around this period of time, we had to pay off that short-term financing and we were able to replace it with short-term financing with Wood, Gundy and the Royal Bank. As part of that arrangement, the Royal Bank insisted that we deposit as collateral, I think, a million and a half dollars time deposit with them in cash. We had a half million dollars, which would have gone to them as part of some other unwindings, and at the same time we had a million dollar loan with the New York agency of the Bank of Montreal secured by 787 shares of Camerina Petroleum Corporation, with a market value of approximately two and a half million dollars. The Bank of Montreal, of course, would not loan 80% on that two and a half million. We needed an extra million dollars. So we asked Powell Morgan if he knew of an American lender who would loan short-term 80% of the value of a listed Toronto security.

Q. Let me be absolutely certain on this. You asked Morgan?

A. I personally asked Morgan.

Q. So that you know personally that it was not the other way around, Morgan coming to you and saying that he had an American lender?

A. I am positive, because we had the need for the money and we had to put this deposit up with the Royal Bank, and this had no connection with Powell Morgan whatsoever. But we scouted around for places where we could find the additional million dollars. This was the best place for us to find it. Otherwise we would have to sell some of the Great Northern securities, which we didn't have a buyer for and some other assets, which were not liquid. So as a rather unpalatable choice, we asked him if he knew some of the money lenders in the U.S. market who loan money in this type of thing.

We had never delved into that market—not that there is anything wrong with it. It's just that we never dealt with Walter Heller or any of the high interest rate lenders.

He called back a few days later and said to me to get in touch with Mr. Adair at Motion Picture Securities, that they had the money they were willing to lend at approximately eight to eight and a half percent interest rate. This was higher than we had ever paid in Lambert and Company, but we wanted to buy and we had no choice in the matter. So I talked to Mr. Adair and we negotiated back and forth several days.

Q. Who participated in those negotiations, just you and he?

A. No, I did the negotiations largely with Mr. Adair, but on occasion either he or I would call Powell Morgan to see if—on my part to see if these terms were reasonable. I never had any experience in this sort of market. I wanted to see if Morgan thought this was a good deal. He had all kinds of deals for me to make elsewhere.

Q. Proceed.

A. To make a long story short, we did borrow the funds, and as you undoubtedly know, it subsequently turned out that Motion Picture had borrowed the money from a subsidiary of Atlantic to lend to us."

Afterwards Mr. Land was candid enough to say that Cushing & Co. was a nominee for Lambert & Co. in transactions where it was not considered desirable for the name Lambert to appear, particularly when high interest rates were being paid, "because our pride was that Lambert and Company never paid that interest rate".

This evidence, and that of C. P. Morgan, who said that the loan to Cushing & Co. had nothing to do with the purchase of Atlantic shares by Great Northern Capital Corporation and, incidentally, that Great Northern and Lambert knew nothing about the means whereby Hugo Oppenheim und Sohn were able to purchase 120,000 shares, taken in conjunction with the documentary evidence referred to, convinced me that the borrowing indirectly from Atlantic by Lambert & Co. was not connected in any way with the purchase of Atlantic shares. There was ample reason for the money being required to secure to Lambert & Co. 85% of the common shares of Great Northern Capital Corporation, but this does not necessarily provide proof that the lending transactions were as open and above board as Christie and Land would like one to think. Any attempt to use the funds of Great Northern Capital by Lambert & Co. to purchase shares of that company on their behalf would have been too obviously improper in the serene atmosphere of Wall Street in which the partners lived and worked, but the loan of \$1,000,000 made to Atlantic by the purchase of a senior note on December 18, 1964, and the prepayment of the Aurora Leasing loan on September 1 by Cushing & Co., achieved only by borrowing from the Bank of Montreal, is difficult to explain except as a means of concealing the fact that the resources of Great Northern Capital's principal subsidiary were deliberately called into play. In any event the loan made by Motion Picture Security Corporation to Cushing & Co. was repaid with interest, approximately when due, after the Atlantic collapse, and the amount shown as outstanding on Table 14, illustrating the history of accounts receivable of Commodore Factors Limited, must be correspondingly reduced. It is, moreover, certain that the shifts to which the Lambert partners were put in December of 1964 and January of 1965 would not have confronted them if Great Northern Capital had not been manoeuvred into the position of having to supply \$2,000,000 to match the purchase by Hugo Oppenheim und Sohn of 120,000 Atlantic shares in the previous September.

Concealment of Atlantic's Payments to Cimcony Limited

If there is doubt about the propriety of these dealings between Morgan and the Lambert partners, there is none about the relationship between Atlantic and Cimcony Limited. The purchase of a \$2,000,000

Atlantic note by Cimcony of Canada Limited and the subsequent re-allocation of these funds as properly secured junior subordinated notes in the hands of American institutional investors in the summer of 1964, for which Cimcony Limited charged a fee of over \$30,000, has already been dealt with in Chapter IX.¹ It was there pointed out that the funds used to purchase the original note were lent to Cimcony of Canada by Aurora Leasing and supplied originally by Atlantic. It has also been seen that Atlantic paid twice for fees in this connection to both Kuhn, Loeb & Co. and Cimcony Limited. Further sums were paid to the latter, and underlying the relationship of this company with Atlantic Acceptance was of course the fact that C. P. Morgan through Mortgage Trust & Savings, his wholly-owned Bahamian corporation, held a quarter interest in its stock

Although Weinrott's memorandum of his discussion with Morgan on May 27, 1964² asserted that Cimcony Limited was to be Atlantic's sole fiscal agent, no hint of this development was given to the finance company's board, and in view of the arrangement with Kuhn, Loeb & Co. this is not surprising. Yet on February 9, 1965 Atlantic paid Cimcony Limited a further sum of \$40,000 in U.S. funds as financial advisory fees, as is indicated by Atlantic cheque voucher No. 1266.³ This 2% of \$2,000,000 in U.S. funds which was the purchase price of 120,000 shares, and this was paid after the sale to Hugo Oppenheim und Sohn had been completed. There is similarly no authority for this payment in any minute of the directors' meetings; indeed the agreement, according to the minutes, was that the shares issued at \$18 Canadian funds per share to Great Northern Capital Corporation would be sold on the same basis, or one not less favourable than that prevailing in the issue to the Berlin bank, \$18 being the net price per share to the company. Under the terms of the agreement between Cimcony Limited and Atlantic, as set out in the former's letter of September 11, the Bahamian company was to be the purchaser of these shares, but, according to Morgan's testimony, did not qualify as an exempt corporation under the regulations of the Toronto Stock Exchange, whereas Hugo Oppenheim und Sohn did. If this was so, Cimcony Limited had even less right to such a payment than would appear to be the case in view of the fact that it was not authorized by the Atlantic board. So conscious of this were the officers of the company that the cheque voucher, which referred to the \$40,000 payment first of all as "deferred share expense", contains an additional notation, made in 1966, which ascribed \$16,030 to sale of senior notes Series "R", \$21,570 to one of "Fourth Series" subordinated notes and \$2,400 to one of medium-term notes.⁴ There was no authority for such payments in

¹pp. 606-7.

²Exhibit 1976.

³Exhibit 3318.

⁴Exhibit 3318.

respect of the issues mentioned, and in fact a minute of February 17, 1965 authorizes Kuhn, Loeb & Co. to receive fees for the Series "R" senior notes and subordinated notes, without making any reference at all to a sale of medium-term notes. Kuhn, Loeb & Co. were in fact paid \$84,100 in U.S. funds on February 26 and the invoice⁵ reads: "For financial advice in connection with the creation of your senior notes Series 'R' and subordinated notes Fourth Series". That there may be no doubt about the manner in which these payments were treated by Cimcony Limited, its balance sheet as at January 31, 1965, produced by the trustee in bankruptcy,⁶ shows commissions receivable as \$176,750, in connection with which the working papers behind the statement show that \$40,000 of this amount was recorded as being in respect of a sale of 120,000 common shares of Atlantic Acceptance, and \$60,000 as 2% on \$3,000,000 worth of junior subordinated notes sold, for which \$31,250 is shown as having been already paid. An explanation, if not justification, may be discerned in the minutes of the Atlantic directors' meeting of September 24, 1964 which authorized a payment of \$100,000 as financial advisory fees in connection with the sale of \$3,000,000 of junior subordinated notes in U.S. funds. This would involve a charge of 3 1/3 %; so high, indeed, that the additional \$40,000 to which Atlantic was committed had to be accounted for in some other way. Weinrott himself provided another version, as will be seen.

Three Versions of the Acquisition of Hugo Oppenheim und Sohn— Tramiel, Morgan and Wirth

No account of the association of the Hugo Oppenheim Bank with the "Canadian bandits" would be complete without an attempt to discover the motives of those who were principally engaged in it. The expressed difference between the views of Morgan and Tramiel has already been referred to. Tramiel said that the idea of investing \$2,000,000 in the Bank, rather than the \$125,000 first contemplated, occurred to Morgan when Tramiel had returned from Germany after making the initial arrangements to acquire an interest in it. He gave the following account:¹

"Q. Did he give you any reason for this suggestion?

A. The only reason he gave me was when I explained to him on what basis the German bank is working on, if they have a higher capital they can borrow more money. This was explained to me. He felt by having a bigger investment in the bank we might be able to borrow more money. And he was explaining to me of the shortage of money that Atlantic Acceptance has.

⁵Exhibit 3319.

⁶Exhibit 3321.

¹Evidence Volume 87, pp. 11818-20.

Q. What is the ratio between the invested capital in the bank and the amount of money that the bank is able to borrow from the public, no doubt in the form of receiving deposits?

A. It was explained to me that they are allowed to borrow twenty times of the capital.

Q. When you say 'borrow', would that mean that there is a ratio fixed between the amount of invested capital in the bank and the aggregate amount they are allowed to have on deposit from customers?

A. No, they are allowed to borrow, this is what was told me, from the other banks, from the central bank. It had nothing to do with deposits.

Q. So, it was your understanding, then, for every dollar of equity in the bank the bank would be entitled to borrow \$20 from the central bank or other banks?

A. This was my understanding.

Q. Just in passing, did that prove to be incorrect?

A. I don't think the law is still correct, but it is still up to the central bank and the other banks to lend money against security.

Q. It is true, you still have to find somebody to lend money?

A. Yes.

Q. All right. What did Mr. Morgan say then, developing the matter on which you have touched?

A. He just mentioned that he would like to invest a greater amount of money, that the bank should be a ten million marks bank.

Q. And how was this going to assist Atlantic to overcome the shortage of money it was experiencing?

A. They would be able to borrow money or sell secured notes or notes of Atlantic or something of this nature. Mr. Morgan mentioned to me he even intends to go to some other European capital and borrowing money. I am not sure if this was the time when there was some restriction from the United States or not.

Q. Then, so I understand that, Mr. Morgan envisaged that the bank in Germany would be able to borrow money, and that the greater the capital of the bank, the more money it could borrow, and that the bank would then be able to lend the money to Atlantic Acceptance, which would assist that latter company in overcoming its problems of getting money?

A. Yes sir . . ."

Morgan's version, which covers considerably more ground, but cannot very well be abbreviated at this point, consisted of a long answer to a question put by Mr. Shepherd:²

"Q. Then what is the whole story starting from the beginning about the acquisition of a German bank, and I believe there were two German banks involved and the one ultimately bought was Hugo Oppenheim?

²Evidence Volume 25, pp. 3395-8.

A. Well, I believe I would like to sort of amplify this.

Q. Yes, please do.

A. At some length. As you are aware and have been aware through all this period in the last eighteen months of Atlantic's existence, that there was a great need for money, it was growing rapidly and had over one hundred branches and the business was tremendous. It was doing roughly \$15,000,000 a month and long term money was getting tighter and the American money was getting tighter as Mr. Johnson put the squeeze on. So one day—and this is important—Mr. Tramiel came to me and he said—he threw a card on my desk, Director General or Managing Director of the Hugo Oppenheim Bank and Son, Berlin, and I said, 'What's this?' He said, 'We bought a bank in Germany', I said, 'Who is we?' He said, 'Well, Trans Commercial Acceptance has bought a bank'. I said, 'Well, this is news to me,' but I said, 'Go on, tell me what the story is.' 'Well' he said, 'The story is this. If you have a capital of 2,000,000 Marks you can borrow in Germany eighteen times this capital', and he said, 'It's important to have' with the connections that he had with regard to Commodore Business Machines, a world wide organization, that he had a constant flow of money. So he felt that through this acquisition of this German bank he could borrow almost an unlimited amount of funds in Germany.

So he said, he passed this information on to me and he said, 'What about the—' I asked him, 'What about the pursuing of capital requirements for Atlantic'. I said I had already told London—I hadn't been to Berlin looking for money but I had been to London and money was available there but you had to have entree in that particular field to get it. But he said, 'There's no problem there,' he said, 'We have all kinds of money offered to the bank on good security.'

So he said, 'Enquire—' and this is where the 120,000 shares were about to be subscribed for. Cimcony in Nassau had agreed to place for \$5,000,000 worth of subordinated notes and take down \$2,000,000 U.S. of equity capital in Atlantic for a price of 4.9 million dollars, in other words a commission of \$100,000. So I had taken, or may be Mr. Davidson had taken this to the Toronto Stock Exchange, and Great Northern was an acceptable borrower, or at least provider of the shares of the company, Cimcony in the Bahamas was not. They had to have a bank or somebody that was an exempt corporation. So the situation on how the transaction resulted was this. Mr. Tramiel also said that the capital of the company, that is the bank, could be sold in Germany for 2 Francs for every one Franc at par value, so here is how the transaction took place. \$2,000,000 was loaned to Evermac with the instructions of putting—increasing the capital from, I think it was 200,000 Marks to 2,000,000—in other words, \$2,000,000 was to go up or be increased, to go from 2,000,000 Marks to 10,000,000 Marks, which is from \$500,000 to two and a half million. There is already 500,000 in it, and the Mark is approximately 25 cents. So the loan was made to Evermac on the security of the stock of the German bank, with the understanding that the German bank would loan the 2,000,000—would sell it rather, in other words subscribe. The stock of Atlantic

was 2,000,000 U.S., and they would turn around and sell it at eighteen to Cimcony in the Bahamas, and this would mean that an exempt name, as far as stock was concerned, would be available for the Toronto Stock Exchange.

After the transaction, where Cimcony would loan some money from Aurora to make the down payment to the German bank as a separate transaction too, that in other words, the transaction was the loan to Evermac secured by the bank stock, then the bank stock—the bank used those funds, in essence subscribed for the Atlantic shares they had sold the stock to Cimcony, they ended up with a loan on their books of \$1,350,000 and it was secured by Atlantic stock.”

Wolfgang Wirth told the Commission that the Bank had deposits of D.M. 3,000,000 on short-term or on demand, and that under German law it was permitted to lend the aggregate of its deposits and invested capital less its reserves, provided that it lent no more than eighteen times its capital. He said that Tramiel had suggested to him that the Bank might invest its capital for the purpose of making a profit to wipe out its loss of D.M. 800,000. Wirth, as the joint general manager with one Werner Lange since October 1, 1964, refused to contemplate this according to his own account; and here it should be said that under German law and practice there are two levels of control in the organization of a bank, the upper level being that of the board of directors and the lower that of the Vorstand or general management, with authority over lending and investing policy which cannot be gainsaid by the board, or so the Commission was informed. Tramiel had returned to the subject, saying that there existed a “house bank” for Commodore Business Machines known as Atlantic Acceptance Corporation and suggesting an investment of \$2,000,000 in Atlantic stock. Wirth again demurred. Tramiel then informed him that there was a group of retired businessmen in the Bahamas known as “Cimcony” who were willing to buy Atlantic stock if the bank would support them, and wait for payment for a period of months; this would eventually provide a fee to the bank of D.M. 800,000. Wirth said he agreed to this proposition if the Bank received one-third of the purchase price in cash and held the Atlantic stock as security against final payment. Two aspects of this version of what transpired are important; in the first place it is clear from this and other evidence that the original plan to have Cimcony Limited acquire the 120,000 shares of Atlantic stock was still in contemplation, and in the second that the Bank’s management complied with the suggestion to buy the Atlantic stock with the greater part of its newly-infused capital.

The Hugo Oppenheim-Cimcony Agreements

Two agreements were found in a file provided by Solomon & Singer, the first being dated November 24, 1964,¹ between Hugo Oppenheim and

¹Exhibit 1000.1.

Sohn and Cimcony Limited. It provided for the sale by the former of 38,500 common shares of Atlantic Acceptance at \$18.10 per share in Canadian funds, for a total purchase price of \$696,850; the law of the contract was to be that of the Federal Republic of Germany, and the articles of the agreement are written first in German and then in English. It was signed for the Bank by Wolfgang Wirth whose signature was witnessed by von Rheden, and for Cimcony Limited by George H. Weinrott whose signature was witnessed by C. P. Morgan. The second agreement, between the same parties,² recited the fact that the vendor, Hugo Oppenheim und Sohn, was the owner of 81,500 shares of Atlantic Acceptance, and in essence provided in its English version that Hugo Oppenheim und Sohn gave an option to Cimcony Limited to buy the remaining 81,500 shares at a price of \$18.10 per share. Cimcony Limited pledged with Hugo Oppenheim und Sohn the 38,500 shares which it had just purchased as security for the fulfilment of the covenants in the agreement by which Cimcony was obliged to pay the Bank \$9,210.69 in Canadian funds each month, described as an "option payment". This amount is approximately the monthly interest at 7½ % on \$1,475,150, for the price of 81,500 shares at \$18.10 per share. The English paragraphs further provided that the 38,500 shares should be transferred back to Cimcony Limited when it had paid the purchase price of \$1,475,150, on or before April 23, 1966. If the market price per share were to decline to \$14.48 per share or less, the Bank was entitled to demand immediate payment, and if this were not made within forty-eight hours, to sell all the shares and reimburse itself. This agreement was signed and witnessed by the same hands and was also dated November 24, 1964, the day that Hugo Oppenheim und Sohn acquired the 120,000 Atlantic shares. According to Wirth and von Rheden, they met Morgan and Weinrott in the latter's office in Nassau and Morgan produced the Atlantic stock. Von Rheden's own recollection was that the four of them went to a bank where Weinrott received a cheque for \$2,000,000 and Wirth one for \$650,000 in U.S. funds.

At first glance, and in view of the existence of a receipt dated November 24, 1964³ in which payment of \$2,160,000 in Canadian funds is acknowledged as having been made by Hugo Oppenheim und Sohn, over the signature of B. L. McFadden for Atlantic Acceptance Corporation, it might appear that von Rheden's recollection was at fault; but this receipt is also a delivery slip of share certificate No. C 6161 for 120,000 common shares of Atlantic and was probably taken by Morgan to Nassau. George Weinrott's version of what transpired was given in the course of his voluntary deposition taken in New York by Mr. Cartwright,⁴ and is interesting on two counts: first, it supports the accuracy

²Exhibit 1000.2.

³Exhibit 3308.

⁴Exhibit 3803.

of von Rheden's account and, second, it throws new light on the nature of the payment of \$40,000 received by Cimcony Limited for the sale of the 120,000 shares.

"Q. Mr. Weinrott, did Cimcony Limited ever actually receive physical possession of these certificates?

A. No, we got the certificates to the best of my knowledge, I am not a hundred per cent sure about this, but the closing in Nassau on this transaction took place I think in the latter part of '64 and the two German bankers and Morgan came to Nassau and as I recall they gave us a receipt, they gave us a receipt for the shares as I recollect it and then took the shares as collateral on an unusual arrangement, I thought, of giving us an option, selling us outright a portion and giving us an option on a portion and using what we bought outright as collateral security for the option.

The net result of this transaction was that we borrowed, Cimcony Limited borrowed \$1,350,000 from the Oppenheim bank for one to two years to the best of my knowledge at seven or eight per cent, and we drew a cheque from Cimcony's funds for approximately \$650,000 making a total of \$2,000,000. We then went down to the Nova Scotia Bank which is in the office building, the same office building with our offices and procured a bank draft for \$2,000,000 payable to Atlantic Acceptance. The cheque for 1,350,000 from the German bank to the best of my knowledge was an American Express cheque.

Q. Mr. Weinrott, did you actually see the two million dollars draft that was prepared by the bank?

A. Yes, I did.

Q. Who actually went to the bank to perform the mechanics of this transaction?

A. All of us. Mr. Morgan, the two Germans and myself."

In the examination of Weinrott for discovery in the bankruptcy of Cimcony of Canada Limited,⁵ also taken in New York, he had this to say:

"Q. Why were you getting a commission from the Atlantic Acceptance Corporation Limited for shares which were bought from the German bank?

A. I will repeat this again for clarification: because the arrangement was made with Mr. Morgan to buy 120,000 shares at \$18.10 a share. It was not made by the German bank, and I hadn't heard of the German bank at that point.

Q. Where was Cimcony Limited to get the money to buy the shares? Did it have \$2,000,000?

A. It didn't have to have it, if it could borrow. At that point we were talking to some New York banks about making a loan with the stock

⁵Exhibit 3411.

as collateral, more or less conventional method, and we would put up the difference between the loan and the cash—we would put that up in cash. We had \$750,000 in the bank. When they came to close this deal, this is the way they had it set: We can't do it that American way. If I remember, there were three members of the bank there and Morgan in Nassau. The way we do it is this way: you buy these shares, give you an option on the balance of the 120,000; you get the same results, you pay interest on the 1.350 million, which we did—we will have a cheque leaf here, you will see the cheque for \$2,000,000 through the Atlantic Acceptance Corporation purchase of this 120,000 shares at \$18.10. This was something brand new to me; I had never seen a loan set up this way before where we got an option on what we owned. We got an option on what we didn't own, the balance between 385 and the other is what? 82?

MR. SCOTT: 81.

Q. 120.

A. Whatever it is. 8,100—81,000 shares, we got an option on that. But when we got through with all of this, the result was exactly the same; no difference. We owed them 1.350 million, we deposited 650 or its equivalent, and we got a cheque for \$2,000,000 made out to Atlantic Acceptance, period.

Q. Why were you entitled to \$40,000?

A. Because we charged a two per cent brokerage fee.

Q. But you were the one that was buying. How could you be a broker?

A. Not a thing in the world to buy stock at a discount, to buy it at \$98 instead of \$100. If that's wrong, there is an awful lot of wrong brokers.

Q. So it wasn't a brokerage, it was a discount?

A. Call it discount, call it brokerage, but we got two per cent for doing the deal."

It seems clear from these quotations that the distinction between purchase and option was of little importance to Weinrott at the time. If Cimcony Limited received \$40,000 as a discount on the purchase of the shares, if, indeed, it is to be treated as a purchase by Cimcony Limited, this arrangement was also clearly a breach of the understanding between Atlantic and Great Northern Capital Corporation.

A curious feature of the second agreement is that, whereas the English version provides for the granting of an option to Cimcony Limited by the Bank, the German version, which presumably takes precedence both by virtue of its position in the text and the fact that the law of the contract is that of the Federal Republic, specifies an outright sale of the 81,500 shares on April 23, 1966 and their delivery in Nassau on that day. Tramiel's evidence supports the latter view of the transaction, as does the nature of the "option payments" which are clearly

calculation of interest on the deferred purchase price. Edgar Hochgraeber told the Commission in Nuernberg that he drew both agreements in German and English and implied that they were to be read together as constituting one instalment purchase, with a down payment provided for by the first agreement, saying further that property in the balance of the shares did not pass under German law until payment was complete. Tramiel said that he did not think Weinrott understood German, and, as it turned out, a mere option would have been more advantageous to Cimcony Limited, in view of the subsequent worthlessness of Atlantic stock, than a purchase of the shares at \$18.10 a share with payment deferred until April 1966. All possible reasons for a difference in concept displayed by the two versions were carefully explored by counsel during the public hearings of the Commission, but it may be that any conflict is more apparent than real, since the German text uses the word "optionsrecht" in places other than the two sub-sections of the first section of the agreement which, according to the translators of the Provincial Secretary's Department, reads in English as follows:⁶

"1. The seller is the owner of 81,500 (in words: eighty one thousand five hundred) shares of the Atlantic Acceptance Corporation Limited, Toronto. The seller sells these shares to the buyer as of April 23rd 1966. The purchase price for each share amounts to Canadian \$18.10, i.e. in total \$1,475,150.00 (in words: one million four hundred and seventy five thousand one hundred and fifty) Canadian Dollars or its equivalent in U.S. Dollars.

2. The total purchase price is to be paid in cash or by cheque certified by a recognized bank against delivery of the shares. Delivery of the shares is to take place on April 23rd 1966 in Nassau, Bahamas."

The English version, as distinct from the translation of these sub-sections, as contained in the agreement reads:

"1. The seller is the owner of 81,500 (in words: eighty-one thousand and five hundred) shares of Atlantic Acceptance Corporation Limited, Toronto. The seller hereby grants unto the buyer an option to purchase the said shares, which option shall lapse on the 23rd day of April, 1966. The price for each share shall be \$18.10 Canadian, i.e. in total 1,475,-150.00 (in words: one million four hundred and seventy-five thousand and one hundred and fifty) Canadian dollars or its equivalent in U.S. Dollars.

2. The total purchase price shall be paid in cash or by cheque, certified by a recognized bank against delivery of the said shares. The delivery shall take place on the 23rd day of April, 1966 in Nassau, Bahamas."

However the second sub-section of the second section of the same version begins, "the buyer shall pay to the seller for this option . . ." and the corresponding German text begins, "Fuer dieses optionsrecht . . .". The

⁶Exhibit 3397.

distinction may well be a fashion of draftsmanship by a German civilian unaware of the potential difficulties of interpretation; in the result Cimcony Limited was able to refuse to complete the purchase after the collapse of Atlantic Acceptance, on the grounds that it was exercising its right to decline under the option. Oddly enough, there is no mention in this second agreement of the contemplated disposition of the 38,500 shares already purchased in the event of the purchaser, or optionee as the case may be, failing to complete its undertaking, but since they were held as security and their transfer back to the purchaser was conditional upon this being done, it may be assumed that they would be forfeit, at least to the extent that the vendor was able to recoup its loss.

It has already been noted that, out of the \$2,750,000 paid by Atlantic Acceptance to Commodore Sales Acceptance on November 10, 1964, which had been paid in turn to Aurora Leasing Corporation and of which \$2,075,000 had gone to Jack Tramiel at Hugo Oppenheim und Sohn in Berlin, the sum of \$537,663.75, or \$500,000 in U.S. funds, plus charges for transmission, was paid by Aurora to Cimcony Limited and was recorded as a loan in that amount to the latter company in the Aurora notes receivable ledger. The loan, bearing interest at $8\frac{1}{2}\%$ per annum, simply remained outstanding thereafter. The unsigned collateral promissory note for \$500,000 in U.S. funds and two letters from Cimcony Limited, one to Mortgage Trust & Savings Corporation and the other to Cimcony of Canada,⁷ have already been referred to in that section of Chapter VIII dealing with trading in the shares of Analogue Controls Inc.⁸ In brief, Cimcony Limited created by this documentation a debt apparently payable to itself from Cimcony of Canada in the amount of \$500,000 U.S. funds which was ostensibly paid by Aurora Leasing sending it a cheque for that amount. Aurora's records treated this as being a loan to Cimcony Limited, Weinrott as being a payment to Cimcony Limited of indebtedness by Cimcony of Canada, and the records of Cimcony of Canada do not treat it at all. Cimcony Limited used the \$500,000, plus an additional \$150,000, to purchase the 38,500 Atlantic shares from Hugo Oppenheim und Sohn, getting the additional \$150,000 by selling preference and common shares to its existing shareholders, Weinrott himself, Carrol M. Shanks, Thomas F. Riley and Mortgage Trust & Savings Corporation. As security Aurora was given 75,000 shares of Analogue Controls and 2,000 of the 8% preferred stock of Cimcony Limited, but the loan was not repaid, and the security must be considered worthless, because Analogue Controls is in receivership and there is no market for the preferred stock of Weinrott's company. Thus Atlantic Acceptance lent to Hugo Oppenheim und Sohn a sum sufficient to pay \$2,160,000 to acquire 120,000 of its own shares, and then, through the medium of other companies, including Aurora Leasing,

⁷Exhibit 2427.

⁸p. 433.

an additional \$500,000 in U.S. funds to enable Cimcony Limited to deal with the same shares, both loans remaining outstanding at the time of the collapse.

Artificial Respiration for Hugo Oppenheim und Sohn

Some repetition is now necessary of the account of transactions considered in Chapter VIII in connection with the affairs of Commodore Business Machines. With the \$650,000 in U.S. funds obtained from Cimcony Limited, Hugo Oppenheim und Sohn entered into an agreement with Five Wheels Limited dated December 1, 1964¹ whereby the latter sold 100,000 shares of Commodore Business Machines to the German bank for \$500,000 Canadian funds in cash; then Hugo Oppenheim und Sohn agreed to pay this price by depositing \$225,000 in the Bank of Montreal to the credit of Five Wheels and \$275,000 to the credit of Trans Commercial Acceptance, on direction given by Five Wheels in both instances. These arrangements were completed on December 8 and must be considered in the light of another agreement of the same date, and expressed to be annexed to the first one, but in fact found separate, between Five Wheels Limited, Trans Commercial Acceptance and Hugo Oppenheim und Sohn,² providing that Five Wheels will lend Trans Commercial Acceptance \$275,000 at 4%, payable as to \$75,000 on April 30, 1965 and \$200,000 on December 30, 1965, and that, as collateral security for the repayment of these sums to Five Wheels by Trans Commercial Acceptance, Hugo Oppenheim und Sohn would pledge with the Crown Trust Company, as escrow agent, 55,000 shares of Commodore Business Machines to be held by it until Trans Commercial Acceptance paid its debt, the bank retaining the right to vote the shares in the interim. The transaction was completed in accordance with these provisions.³ Trans Commercial Acceptance at this time was owned by Associated Canadian Holdings, and the price of Commodore Business Machines shares on December 1, 1964 was quoted at a high of \$6.50 and a low of \$6 per share. On December 7, when the deposit of \$275,000 was made for the benefit and to the credit of Trans Commercial Acceptance, the price varied between 6 $\frac{5}{8}$ and 6 $\frac{3}{8}$. It will be recalled that Five Wheels had obtained its 100,000 shares of Commodore Business Machines at a price of \$5 per share on July 10, 1963 in exchange for 100,000 of its own shares for which Associated Canadian Holdings ultimately paid \$750,000.⁴ Hugo Oppenheim und Sohn did not continue to hold its 100,000 shares of Commodore Business Machines, because, by the terms of an agreement between it and Trans Commercial Acceptance dated December 12, 1964⁵ they were sold to Trans Commercial Acceptance for \$650,000, together with the \$1,000,000 worth of

¹Exhibit 996.1.

⁴Chapter VIII pp. 351-3.

²Exhibit 996.2.

⁵Exhibit 998.1.

³Exhibit 3400.

subordinated notes and \$1,000,000 worth of preference shares of Commodore Business Machines at a \$75,000 discount. This transaction, and the means by which Hugo Oppenheim und Sohn acquired the funds to complete it, have already been described.⁶ It was closed on December 29 and on that day the common shares of Commodore Business Machines traded between \$7 and \$7.25 per share. The total number traded that day on the exchange was only 5,305, so that the block of 100,000 was obviously traded off the market.⁷ By its unnecessary intervention in these transactions Hugo Oppenheim und Sohn made a total profit of \$225,000, and by the end of its fiscal year it had, at least temporarily, been rescued from insolvency.

However Hugo Oppenheim und Sohn was not to be paid \$650,000 by Trans Commercial Acceptance in cash, but by two notes, one for \$300,000 due April 15, 1965, and the other for \$350,000 due October 15, 1965. Although unexecuted copies of the notes were attached to the agreement between the parties, no executed copies have been found. The April 15 payment was actually made by Trans Commercial Acceptance through Hugo Oppenheimbank (Canada) Limited, the genesis of which must be described. A note about it is contained in the first of the Arthur Andersen & Co. reports available to the Commission, made with reference to the audit of Hugo Oppenheim und Sohn as at December 31, 1964. It may be said parenthetically that these are very complete and, indeed, discursive reports, made in a prescribed form in accordance with the German regulations on the subject. An English version⁸ contains the following comment on page A6:

"a) Formation of Hugo Oppenheimbank (Canada) Ltd.

In the course of a meeting of the Board of Directors dated December 12 1964 Management was authorized to organize a subsidiary company in Canada in accordance with recommendations made by the Board.

Prior to this, the recommendation was made to management at a meeting of the Board dated October 1 1964 to acquire the existing finance company Trans Commercial Acceptance Ltd. as a subsidiary, of course after completing the necessary scrutinies and investigations. However, after checking out Trans Commercial Acceptance Ltd., Baron von Rheden-Rheden, Deputy Chairman of the Board, and Mr. Wirth, member of the Management, gained the conviction that it would be of greater advantage not to acquire an existing finance company but to form a new company. The formation of the Hugo Oppenheimbank (Canada) Ltd. was then taken into consideration and a draft of a partnership agreement drawn up with the help of the Canadian firm of solicitors Solomon and Singer. This draft agreement contained the following provisions:

⁶Chapter VIII pp. 399-401.

⁷Exhibit 2132.

⁸Exhibit 3296.

- (1) Transactions of a certain magnitude may only be closed with the approval of the management of the Hugo Oppenheim & Sohn Nachf. Berliner Privatbank.
- (2) Composition of the Board of directors:
 - Baron von Rheden-Rheden
 - Mr. Wirth
 - Mr. Jack Tramiel
 - Mr. Solomon, solicitor
 - Mr. Draper.
- (3) Names of officers:
 - Mr. Jack Tramiel
 - Mr. Solomon, solicitor
 - Mr. Draper.

As already mentioned, the formation of the Hugo Oppenheimbank (Canada) Ltd. was approved by the Board of Directors in its meeting of December 12 1964, providing its recommendations and the provisions of the partnership agreement were observed.

Thereupon, Hugo Oppenheim & Sohn Nachf. Berliner Privatbank AG produced the original capital of \$Can 250,000.00 in the form of a cheque dated December 15 1964, made payable to the order of the Hugo Oppenheimbank (Canada) Ltd. which was about to come into being. This cheque was cashed on December 18 1964 by the Trans Commercial Acceptance Ltd. which, apparently, is feasible under Canadian law. The Hugo Oppenheimbank (Canada) Ltd. was established on December 22 1964, without the participation of the parent company. The restrictive provisions of the partnership draft agreement, in particular the provision pertaining to the composition of the Board of Directors, and the provision that transactions of "a certain magnitude" require the approval of the parent company, were ignored.

On December 24 1964, the Hugo Oppenheimbank (Canada) Ltd., without the knowledge of the officers of the Company, acquired a 100% interest in Trans Commercial Acceptance Ltd. from Associated Canadian Holdings Ltd., that is an interest in a finance company the acquisition of which was turned down by Mr. Wirth, an officer of the Company and by Baron von Rheden-Rheden, deputy chairman of the board. In the course of a meeting of the Board of Directors of the Hugo Oppenheimbank (Canada) Ltd. the capital stock of the Hugo Oppenheimbank (Canada) Ltd. was transferred to the Hugo Oppenheim & Sohn Nachf. Berliner Privatbank AG.

The establishment of the Hugo Oppenheimbank (Canada) Ltd. in its present form has not had the approval expressis verbis of the officers nor of the Board of Directors of the Hugo Oppenheim & Sohn Nachf. Berliner Privatbank. The same applies to the acquisition of a 100% interest in Trans Commercial Acceptance Ltd. by Hugo Oppenheimbank (Canada) Ltd. The subsequent silent approval may however be taken for granted. The Bank was only notified of the incorporation and of the subsequent acquisition of Trans Commercial Acceptance Ltd. after the last day of its business year under review.

The books of the Hugo Oppenheimbank (Canada) Ltd. and those of its fully owned subsidiary, Trans Commercial Acceptance Limited, were examined as of December 31 1964 by the Canadian firm of chartered accountants Wagman, Fruitman and Lando. Copies of these auditors' reports are attached and numbered App. VII and VIII. They bear the date Jan. 15, 1965."

Hugo Oppenheimbank (Canada) Limited was, indeed, incorporated on December 22, 1964,⁹ and two days later sent a cheque to Associated Canadian Holdings, signed by Jack Tramiel and F. S. Draper, as officers of the new company, in the amount of \$115,000.¹⁰ A covering letter¹¹ describes this as being for all the issued capital stock of Trans Commercial Acceptance. According to the financial statement of Trans Commercial Acceptance at December 31, 1964, prepared after audit by Wagman, Fruitman & Lando, the assets of the company consisted of its investment in notes, preference shares and common shares of Commodore Business Machines to the extent of \$2,650,000, offset by the fact that it had borrowed all the money necessary to acquire them, plus notes receivable of slightly over \$450,000. The net shareholders' equity was \$116,796, so that Hugo Oppenheimbank (Canada) acquired the shares of Trans Commercial Acceptance at approximately book value, and Hugo Oppenheim und Sohn carried on its own books the investment in Trans Commercial Acceptance, made through the medium of its Canadian subsidiary, in that amount. It also was able to record an investment based upon the higher value of the securities owned by Trans Commercial Acceptance as established by its own sale of them to that company, as well as the profit which it gained by making the sale to Trans Commercial Acceptance just before the latter was acquired by Hugo Oppenheimbank (Canada).

The observation in the Arthur Andersen report about Trans Commercial Acceptance being able to cash a cheque of Hugo Oppenheim und Sohn, made payable to Hugo Oppenheimbank (Canada) "under Canadian law", and the bitter comments made by Wirth and von Rheden about Tramiel foisting Trans Commercial Acceptance on to them as their Canadian subsidiary, when after examining its books they were disinclined to buy it and had elected to establish a new subsidiary company bearing the German bank's name, do not entirely do justice to the situation. After returning from Nassau to New York at the end of November, Wirth and von Rheden made an expedition to Toronto, and it was there that the reported argument with Tramiel and Kapp developed. Tramiel's account is that they were aware of the fact that an investment in a foreign finance or investment company required the approval of the Berlin branch of the Central Banking Authority, or Landes Zentralbank

⁹Exhibit 405.

¹⁰Exhibit 3403.

¹¹Exhibit 999.1.

Berlin, and that it would be more certain, as well as expeditious, if the German bank were to cause its own subsidiary to be incorporated in Canada, particularly since the year-end impended and important and profitable transactions had to be recorded before it expired. As for the cheque which supplied the funds with which Hugo Oppenheimbank (Canada) bought the shares of Trans Commercial Acceptance, a deposit of \$250,000 was recorded in the Hugo Oppenheimbank (Canada) account at the Bank of Nova Scotia in Toronto¹² on December 29, derived from a cheque dated December 15, drawn on the Bank of Nova Scotia's Toronto branch by Hugo Oppenheim und Sohn.¹³ Wirth and von Rheden expressed the view that they had taken such steps as were necessary to see that the money could not be withdrawn from the subsidiary company's account without their permission, but since all the details of incorporation and banking were handled in the offices of Solomon & Singer, a firm which they knew, according to their own statements, represented Tramiel and Kapp, it is not surprising that Tramiel and Draper had signing authority on the new company's bank account.

The books of Hugo Oppenheimbank (Canada) show the receipt of this \$250,000 from the parent bank on December 29 as consideration for share capital issued. By the next day only \$700 remained in the company's account. Other than the payment of \$115,000 to Associated Canadian Holdings, there was a cheque dated December 23, 1964, payable to Trans Commercial Acceptance, in the amount of \$100,300¹⁴ which was used to buy from that company 1,900 shares of Atlantic Acceptance at a price of \$20 per share, for a total consideration of \$38,000, and 8,900 common shares of Commodore Business Machines at a price of \$7 per share for a total of \$62,300. The balance of \$34,000 was paid out by cheque to Trans Commercial Acceptance dated December 30 and recorded in the books of both companies as a loan from Hugo Oppenheimbank (Canada) to Trans Commercial Acceptance. This amount of \$34,000 is accounted for, if one can use that term, by Trans Commercial Acceptance paying Hugo Oppenheim und Sohn, by cheque dated December 24, the sum of \$15,000,¹⁵ negotiated on December 29, but not recorded in the books of the Bank in Berlin; it was repaid on January 5, 1965, and apparently went in and out over the year-end. Then, with the remainder of the money and a good deal more, Trans Commercial Acceptance drew a cheque dated December 30, 1964 in favour of Hugo Oppenheim und Sohn in the amount of \$150,000, recording it as a loan to the Bank which was treated as such in the latter's audited financial statement. This money was also repaid Trans Commercial Acceptance on January 15, 1965. Any purpose of these

¹²Exhibit 3404.

¹³Exhibit 3405.

¹⁴Exhibit 3407.

¹⁵Exhibit 3409.

loans and repayments other than to improve the 1964 statement of the German bank is difficult to discern, but it seems clear that such activity does not support the view that the deputy chairman, Baron von Rheden, and the general manager, Wolfgang Wirth, were entirely innocent victims of the manipulations of Tramiel, Kapp and Morgan. In any event Arthur Andersen & Co. accepted it with reservations. With respect to the transactions previously described, whereby the bank made a profit of \$225,000, the auditors said: "Out of the total profit derived from business and securities (about 968,300 D.M.) no less than about D.M. 955,800 is derived from the aforesaid transactions. Without this revenue there would have been a loss for the year of about D.M. 601,500 (year previous 345, 800). The operating loss would have been about D.M. 302,-300 (year previous 190,600)."

The German Bank's 120,000 Atlantic Shares

The share registers of Atlantic Acceptance Corporation, kept by Eastern & Chartered Trust Company,¹ show that the 120,000 shares which were sold to Hugo Oppenheim und Sohn, and apparently resold to Cimcony Limited, were all registered in the name of the former in November 1964. Von Rheden recalled that Wirth had asked C. P. Morgan if it were possible to break up the certificate for 120,000 shares, brought to Nassau on November 24, into smaller denominations so that they could be used for collateral, and Morgan had said that this presented no problem. In December 10,000 shares were transferred by the Bank into street form, and in March 1965 5,000 shares were transferred out of its name because of a sale of this number of shares by Cimcony Limited to Jack Tramiel; he drew a cheque on the Mercantile Bank of Canada in the amount of \$95,000 in Canadian funds in favour of Cimcony Limited on March 2, 1965² which resulted in a deposit in the Bank of Nova Scotia account of Cimcony Limited in Nassau of \$87,079.70 in U.S. funds.³ The share transfer records show that on March 2, 5,000 shares, formerly registered in the name of Hugo Oppenheim und Sohn, were transferred to Mertor & Co., a street name for the Mercantile Bank. The second report of Arthur Andersen & Co., made as a result of its audit of the books of Hugo Oppenheim und Sohn for the year ended December 31, 1965,⁴ shows that the bank claimed to have owned, at July 16, 1965, 113,000 Atlantic common shares. Evidently Cimcony Limited was permitted to sell 5,000 of the 38,500, bought by it and pledged back to Hugo Oppenheim und Sohn, to the chairman of the Bank's board, and to make a small but significant profit by selling them at \$19 per share. None of the money paid by Tramiel was, however, remitted to Hugo

¹Exhibit 3416.

²Exhibit 3412.

³Exhibit 3413.

⁴Exhibit 3414.

Oppenheim und Sohn by Cimcony Limited, and the former's security was simply reduced by 5,000 shares. What happened to the balance of 2,000 shares required to explain the decline in the Bank's holdings to 113,000 is not known from the records of the transfer agent, but these provided material, together with the Arthur Andersen report, for the following analysis of the disposition of the Bank's 120,000 shares, which had on November 30, 1964 been broken up into ten certificates for 12,000 shares each:⁵

**Disposition of 120,000 Shares of Atlantic Acceptance
Purchased November 24, 1964**

	<i>No. of Shares</i>
November 24, 1964—Purchased by Hugo Oppenheim & Sohn from Atlantic Acceptance—	
Treasury stock	120,000
—Sold to Cimcony Limited (Nassau) (38,500)
	81,500
—Retained by Hugo Oppenheim & Sohn as security for the agreement with Cimcony Ltd. (Nassau)	38,500
	120,000
March 3, 1965 —Sold to J. Tramiel by Cimcony	5,000
—Disposition unknown ..	2,000
	7,000
July 1, 1965 —Said to be owned by Hugo Oppenheim & Sohn as a result of Cimcony's failure to honour an agreement.....	113,000

Location of Shares at June 17, 1965

Said to be in the safe of Hugo Oppenheim & Sohn	1,100
Held by Eastern and Chartered Trust as security for a loan of \$100,000 to Hugo (Canada) (later sold to realize security)	11,390
Held by the Mercantile Bank as partial security for a loan of \$175,000 to Associated Canadian Holdings (later sold to realize security)	2,100
Held by Traders Realty Limited as security for loans to Commodore Business Machines and said to have been bought by J. Tramiel and M. Kapp under an option arrangement	75,000
Held by O'Brien & Williams along with additional shares purchased in the open market as security for the margin amount of Hugo (Canada) (later sold to realize security)	23,400
Unaccounted for	10
	113,000

⁵Exhibit 3415.

The most arresting feature of this schedule is the fact that only 1,100 shares were apparently in the physical possession of Hugo Oppenheim und Sohn in Germany on June 17, 1965, the date of the Atlantic receivership, although 113,000 shares were said to be owned by the Bank as at July 1. After the sale to Tramiel by Cimcony Limited of 5,000 shares, and the unexplained disposition of a further 2,000, the next significant transfer was that of 11,390 shares lodged as security for a loan of \$100,000 made by Eastern & Chartered Trust Company to Hugo Oppenheimbank (Canada). The pledge to the trust company took place on March 24, 1965, as shown in the transfer records, and after the Atlantic collapse this loan remained unpaid and the security was sold, leaving \$10,000 still owing.

One of the certificates for 12,000 shares, into which the original block of 120,000 shares was transferred, was C6197. On December 9, 1964 this was again subdivided and two certificates, Nos. C6328 and C6329, each being for 1,000 shares, were registered in the name of the stock-broking firm of O'Brien & Williams. A broker's receipt given by Barrett, Goodfellow & Co. on March 4, 1965⁶ shows that it received 4,000 shares of Atlantic in the form of twenty certificates for 100 shares, and two certificates, C6328 and C6329, for 1,000 shares each, traceable to Hugo Oppenheim und Sohn. The 4,000 shares were received into the account of Associated Canadian Holdings, pursuant to instructions given by Jack Tramiel as president of the company on the same date,⁷ to hold against payment by Barrett, Goodfellow & Co. to Associated Canadian Holdings of \$100,000. Other securities, including those of Commodore Business Machines, were also received in respect of this payment, but are not relevant to this particular point. Further identification of the certificates is provided by a letter dated April 14, 1965 from Associated Canadian Holdings over the signature of Harry Wagman, addressed to Hugo Oppenheim und Sohn to the attention of Manfred Kapp at the address of Commodore Business Machines in Scarborough.⁸ This letter says: "We enclose herewith our cheque in the amount of \$420.00 representing dividend credit to us relating to Atlantic Acceptance Corporation shares dividends on 2,100 common shares owned by you." The additional 100 shares have not been traced, but presumably were among the 20 certificates in that denomination held by Barrett, Goodfellow & Co. This firm then paid \$100,000 to Associated Canadian Holdings which, according to its cash disbursements ledger,⁹ paid the money to Jack Tramiel, noting that it was for "investment in L.B.H.". Something between \$40,000 and \$42,000 of the \$100,000 supplied to Tramiel was represented by the 2,100 shares belonging to Hugo Oppenheim und Sohn lodged with

⁶Exhibit 3417.

⁷Exhibit 3418.

⁸Exhibit 3419.

⁹Exhibit 2165.

Barrett, Goodfellow & Co., and these were never returned to the Bank in Berlin. The shares are shown on the schedule as located, on June 17, 1965, at the Mercantile Bank of Canada, held as partial security for a loan of \$175,000 to Associated Canadian Holdings and later sold to realize the security. Tramiel said, in his evidence to the Commission, that the \$100,000 was invested in L.B.H. Management Limited at Morgan's request. He said further that he believed all the shares of Atlantic pledged with Barrett, Goodfellow & Co. belonged to Associated Canadian Holdings, and that the 120,000 shares of Atlantic purchased by the German bank had been sent to Toronto by mail, or brought to Toronto personally by himself to be held by Hugo Oppenheimbank (Canada), and thus enable Cimcony Limited to obtain the full dividend without deduction of withholding tax on those shares which it, in turn, had purchased. This was done first, according to Tramiel, in February, 1965, but does not of course explain the break-up of share certificate C-6197 by the transfer agent in December of 1964. His answers to Mr. Shepherd given as the examination proceeded are instructive.¹⁰

“Q. Who had physical possession of these shares?

A. I believe Hugo Oppenheim (Canada).

Q. Where?

A. In Toronto.

Q. In a safety deposit box?

A. I believe so. I really don't know.

Q. Who would be the officers of Hugo Oppenheimbank (Canada) Limited?

A. I believe that I was the president of the company. I'm not sure. Was I?

Q. Yes.

A. Wasn't the Baron the president? I was an officer of the company.

Q. You were the Canadian officer in any event, were you not?

A. Yes.

Q. Let me put this to you. Did Hugo Oppenheim und Sohn Privatbank Berlin authorize the pledging of any shares of Atlantic Acceptance Corporation Limited to stand as security for moneys advanced to Associated Canadian Holdings Limited?

A. I don't know if each specific loan was given an approval, but I know there was a total approval, but as far as the dealings in Canada is concerned I think they even gave me a letter that we can deal, buy and sell securities in Hugo Oppenheim (Canada) on behalf of the German bank.

¹⁰Evidence Volume 87, pp. 11856-63.

Q. Could you pledge the securities of the bank or its subsidiary for the benefit of another company, that is what I am trying to get at.

A. That way you are putting it to me, I am only guessing, and from my own guessing I don't think I could for another company, but if the individuals who owned the companies would have agreed to it, like I said, I would have done it. I didn't do it on my own, if it was done. I don't recall any particular case like this.

Q. Let us deal specifically with these 4,000 shares which were pledged with Barrett, Goodfellow.

A. Well, could you show me those documents, sir?

Q. Yes. Could I have Exhibit 3418, please. I begin by showing you Exhibit 3418, which is a printed form addressed to Barrett, Goodfellow and Company, dated March 4, 1965, reading:

'Please accept this document as your authorization to receive from Associated Canadian Holdings 4,000 shares of Atlantic Acceptance Corporation for their account against payment by you of \$100,000, the debit to be passed to their account.

Yours very truly,
Associated Canadian Holdings
(Signed) Jack Tramiel'

That is your signature, Mr. Tramiel?

A. Yes.

Q. Can you assist us as to where those shares came from?

A. I believe from Associated Canadian Holdings.

Q. You believe that they are the property of Associated Canadian Holdings?

A. Yes, sir.

Q. Did Associated Canadian Holdings buy any part of the block of 120,000 shares from Hugo (Berlin)?

A. This I couldn't assist you.

Q. If Associated Canadian Holdings did purchase any of that block of shares, would it be fair to suppose that it would be recorded in the books of Associated Canadian Holdings and in the books of Hugo Oppenheim (Berlin)?

A. Are you asking me to guess?

Q. You mean that you consider it quite possible that Associated Canadian Holdings would have purchased \$80,000 worth of shares from Hugo Oppenheim (Berlin) and the transaction would not be recorded in Associated Canadian Holdings books or the books of Hugo (Berlin)?

A. As far as Associated is concerned I couldn't answer you, because Mr. Wagman was handling the books. As far as—

Q. Dealing then with those very shares which you directed Barrett, Goodfellow to hold, can you tell us whether or not Hugo Oppenheim (Berlin) or Hugo Oppenheimbank (Canada) authorized the pledging of those shares for the benefit of Associated Canadian Holdings?

A. Mr. Shepherd, do we have here a statement from Associated which shows the securities which Associated held?

Q. Yes, certainly, Mr. Tramiel.

A. On that day.

Q. We also have several hours of evidence showing that those shares came from the block of 120,000 shares owned by Hugo (Berlin).

A. Well, I'm not talking of evidence. As far as do we have—can I see that list?

Q. Yes, of course. Then you will be able to assist us, will you, and you will be able to say that those shares are the property of Associated Canadian Holdings or are not the property of Associated Canadian Holdings.

A. Only by guessing. I know that—

Q. Well, is it of a great deal of assistance and worth the time and trouble, Mr. Tramiel, if you are not going to be able to assist us much more than that?

A. No, because I do recall in my mind Associated Canadian Holdings did own a certain amount of Atlantic stock.

Q. Indeed they did, Mr. Tramiel. There is no question about that. I concede it readily.

A. If they did, why didn't they transfer their own stock?

Q. Mr. Tramiel, the question I am putting to you is: There has been a great deal of evidence before this Commission that this stock appears to be the property of Hugo Oppenheimbank (Berlin). I am asking you, can you tell us where that stock came from, or can you tell us whether or not Hugo Oppenheimbank (Berlin) authorized the pledging of shares which were its property for the benefit of Associated Canadian Holdings?

A. My answer is that if Associated did not buy the stock, then the stock belonged to Associated Canadian Holdings, which they have given to Barrett, Goodfellow.

Q. I show you a letter, Exhibit 3419, addressed to Hugo Oppenheim und Sohn Nachf, but the address is shown as 946 Warden Avenue, Scarborough, Ontario, 'Attention Mr. Kapp' and signed by Mr. Wagman. I will read it:

'Dear Sir:

We enclose herewith our cheque in the amount of \$420, representing the dividend credit to us and relating to Atlantic Acceptance Corporation shares dividend on 2,100 common shares owned by you. We trust you will find this in order and remain,

Yours truly,
Associated Canadian Holdings,
per H. Wagman.'

There is attached a deposit receipt indicating that that \$420 was deposited to the account of the Berlin bank here in Canada. Can you assist us as to why Associated Canadian Holdings is paying to the Berlin bank a dividend arising out of shares owned by the Berlin bank but received by Associated Canadian Holdings?

A. Mr. Shepherd, if the shares were made out to the German bank, wouldn't the dividend be sent directly to the German bank?

Q. Oh, Mr. Tramiel, I suggest that since you were dealing with this block of shares, you know as well as I do that many of those shares were registered in the name of O'Brien and Williams, they were in street form.

A. So they were not in Hugo Oppenheim's name.

Q. Quite correct, they were not registered in the name of Hugo Oppenheim; they were in street form. Why is Associated Canadian Holdings sending a dividend cheque to Hugo (Berlin) bank for shares owned by the Hugo (Berlin) bank if Associated Canadian Holdings does not have any shares which were owned by the Hugo (Berlin) bank?

A. I couldn't answer you. It could have been they paid it after the dividend or before the dividend, and this particular letter I have never seen and I didn't know Mr. Wagman is so formal of sending out letters like this. It was always discussed verbally.

Q. Did Mr. Wagman write, so far as you were aware, on many occasions to the Hugo Oppenheimbank of Berlin addressed to the address of Commodore Business Machines on Warden Avenue?

A. I don't recall any letters.

Q. Is there anything further you can assist us on in respect of this matter, or may we pass on?

A. I believe I gave you the answer as much as I can."

The next item on the schedule respecting location of shares shows that 75,000 were, on June 17, 1965, held by Traders Realty Limited for loans made to Commodore Business Machines. It will be remembered that these shares appeared in June in this character in connection with the purchase by Commodore Business Machines of ~~Willson Stationery~~ * & Envelopes Limited. This transaction, in which \$3,000,000 was lent by Traders Realty Limited to accomplish this purpose, has already been dealt with at some length in Chapter VIII¹¹ with an undertaking to deal at greater length with those aspects of it which involved Hugo Oppenheim und Sohn. In the process some repetition may be necessary. The agreement between Traders Realty Limited, Commodore Business Machines and Tramiel and Kapp individually, dated June 10,¹² has already been referred to and quoted. In it Jack Tramiel and Manfred Kapp warranted that they were, in respect of 37,500 common shares of Atlantic

¹¹pp. 481-4.

¹²Exhibit 3420.

Acceptance each, the owners of them free and clear of all encumbrances, and that they would have "full right and authority to assign and pledge the same to Traders in accordance with the provisions hereof and to deliver to Traders certificates representing the same." Also quoted was an agreement between Hugo Oppenheimbank (Canada) and Tramiel and Kapp, dated June 11, 1965,¹³ in which the German bank's subsidiary is described as the vendor of the shares and Tramiel and Kapp as purchasers, and providing that it sell the shares to them at a price of \$20 per share, or \$1,500,000 payable by means of a promissory note set out as a schedule. Section 2 of this agreement reads:

"2. The Vendor represents and warrants as of the date of closing and hereby acknowledges and confirms that the Purchasers are relying upon such representations and warranties in connection with the purchase and sale hereinbefore agreed upon:

- (a) the Vendor is the owner of the said Atlantic shares; and
- (b) the said Atlantic shares are free and clear of any and all liens, charges and encumbrances of every nature and kind whatsoever."

This representation is one of two conditions to which the purchaser's obligation to repay the \$1,500,000 are subject; the second is the delivery by the vendor of a "Put Option Agreement", in a form provided by a second schedule to the main agreement, which is executed for Hugo Oppenheimbank (Canada) by Jack Tramiel, as president, and F. S. Draper, and by Jack Tramiel and Manfred Kapp personally with their signatures witnessed by Irwin Singer. The "Put Option Agreement" provides that Hugo Oppenheimbank (Canada) will repurchase the 75,000 shares at any time up to March 14, 1966 at a price of \$20 per share, Tramiel and Kapp in the meantime being entitled to the dividends. The third document relating to this transaction may again be quoted in full. It is a memorandum to Hugo Oppenheimbank (Canada) Limited from the parent bank in Berlin and has been quoted before:¹⁴

"To Hugo Oppenheimbank (Canada) Limited

The undersigned shareholder of Hugo Oppenheimbank (Canada) Limited, hereby consents to the sale by the Company to Jack Tramiel and Manfred Kapp of 75,000 common shares in the capital stock of Atlantic Acceptance Corporation Limited, at the price of \$20.00 (Canadian) per share, in accordance with the terms and conditions of an Agreement dated June 11, 1965.

Dated this 11th day of June, 1965

HUGO OPPENHEIM und SOHN Nachf.,
BERLINER PRIVATBANK, A.G.

Per: 'Wolfgang Wirth'

Per: 'Werner Lange' "

¹³Exhibit 997.1.

¹⁴Exhibit 997.2.

It has already been remarked that the typing of the date "June 11th" on this document showed signs of alteration, and when this was put to Tramiel in the course of his evidence he maintained that he was in Berlin so often at this time that he could not remember when he had received it, or under what circumstances. It seems probable that it was made to appear to correspond with the date of the agreement between Hugo Oppenheimbank (Canada) and Tramiel and Kapp. According to Wirth, the Bank received a promissory note from Tramiel in connection with this purchase, but the terms of the consent quoted above would not appear to require it and he was, no doubt, thinking of the note given to the Canadian company.

Later, when the Atlantic stock was worthless, but after it had served its purpose in the Willson Stationers transaction, Tramiel and Kapp gave formal notice of their intention to put it to Hugo Oppenheimbank (Canada) at \$20 per share in a letter dated October 15, 1965,¹⁵ addressed to the company in care of the Montreal Trust. The proceeds were to apply against the loan of \$1,500,000 secured by their promissory note on which no interest had been paid. On October 18 they did so, and tendered the 75,000 shares by letter¹⁶ in the form of one endorsed certificate¹⁷ which was declined. The effect was to stop interest running against them, except on the balance of some \$30,000 which was the interest accrued to date. A photostatic copy of share certificate No. C-7057 for 75,000 shares of Atlantic Acceptance was produced by Tramiel in his evidence taken on December 6, 1966.¹⁸

It is difficult to believe that the management of Hugo Oppenheim und Sohn were not aware of the difficulty in which they had placed their bank by thus parting with nearly all of the shares of Atlantic which they were bound to deliver to Cimcony Limited, had they been called for by that company. At the time the Bank would have had to pay upwards of \$20 per share to replace them, instead of the \$18.10 for which Cimcony Limited had contracted, and probably a good deal more to fill their orders had the unforeseeable collapse of Atlantic not taken place. It is also difficult to believe that every detail of the acquisition of the consent signed by the Bank, which was so vital to the undertakings given by him and Kapp, was not imprinted in indelible characters on the memory of Jack Tramiel, who professed before the Commission, only eighteen months later, to have but the vaguest recollection of how it was obtained.

The remainder of the shares shown in the schedule, amounting to 23,400, with the exception of ten never accounted for, were at June 17, 1965 in the possession of O'Brien & Williams as security for the margin account operated by Hugo Oppenheimbank (Canada). These were sold

¹⁵Exhibit 3423.

¹⁶Exhibit 3424.

¹⁷Exhibit 3639.

¹⁸Exhibit 3639.

subsequently to realize the security. In an agreement entered into between Tramiel and Hugo Oppenheim und Sohn on July 1, 1965,¹⁹ which will be referred to again in connection with the settlement reached after the collapse of Atlantic, there is a reference under paragraph 7 to the 1,100 shares of Atlantic stock in the Bank's safe in Berlin, and to 111,900 shares as being located at "Oppenheimbank (Canada) Limited". With all the 120,000 shares which it had originally held thus scattered to the four winds by sale and pledge, Hugo Oppenheim und Sohn on June 25, 1965 took steps to exercise its right to require Cimcony Limited to pay for the 81,500, not already purchased, at a price of \$18.10 if the price per share fell below the level of \$14.48. Its notice to Cimcony Limited in Nassau, bearing the signs of extreme haste and no respite for rendering into idiomatic English, was as follows:²⁰

"Messrs.

Cimcony Limited

June 25th, 1965

Wi/U

Bernard Sunley Building

P.O. Box 272

Nassau, N.P.

Registered

Air Mail!

Bahamas

Express!

Gentlemen,

According 4,1 of our contract of 24th November 1964 regarding:
Atlantic Acceptance—shares we demand to pay to us the price of
canadian \$18.10 per share
within 48 hours

to our account at the Bank of Nova Scotia, Toronto Branch. If you are not ready or not in the position to pay your liability, we are beginning the execution, at first in the shares and then in your fortune.

Yours sincerely,

HUGO OPPENHEIM & SOHN NACHF.
BERLINER PRIVATBANK

(Wirth)

Aktiengesellschaft"

On this date common shares of Atlantic Acceptance were selling on the Toronto Stock Exchange at prices between \$7 and \$6, and two days later had fallen to \$5 per share.

Investment by Hugo Oppenheim und Sohn in Shares of Commodore Business Machines and Analogue Controls

According to the report of Arthur Andersen & Co. accompanying the financial statements of Hugo Oppenheim und Sohn as at December 31, 1965, the Bank traded in other Canadian securities and, specifically,

¹⁹Exhibit 3426.

²⁰Exhibit 3425.

bought 40,509 common shares of Commodore Business Machines and D.M. 525,000 of Commodore Business Machines debentures. It further states that the bank paid D.M. 405,000 to Evermac Office Equipment Company on April 15, 1965 to buy shares of Commodore Business Machines which it had never received. The books of account of Evermac¹ show that on that day it received \$110,000 in cash from Hugo Oppenheim und Sohn, crediting this amount to a suspense account, which indicated that no decision had been made as to what was to be done with the money. Then on May 1 an adjustment was made by journal entry and the amount was credited to loans payable to Trans Commercial Acceptance, while that company on May 1 recorded a loan receivable from Evermac in the amount of \$110,000, crediting that amount to Hugo Oppenheim und Sohn. Thereafter Evermac decided to treat the payment as though it had been made to it by Trans Commercial Acceptance, and Trans Commercial Acceptance, in its books,² as if it had been made to it by Hugo Oppenheim und Sohn. Another amount of \$10,000 was received by Trans Commercial Acceptance from Hugo Oppenheim und Sohn during May, and on May 31 Trans Commercial Acceptance recorded the sale by it to Hugo Oppenheim und Sohn of 24,800 shares of Commodore Business Machines at \$10.25 per share and treated the \$120,000 received from the Bank as part payment on this trade. No shares were ever delivered to Hugo Oppenheim und Sohn, as a result of this, according to the Arthur Andersen & Co. report. It would appear, from adding together the book value of the shares of Atlantic Acceptance and Commodore Business Machines held by Hugo Oppenheim und Sohn, or perhaps by Hugo Oppenheimbank (Canada) if certain documentation is accepted, that at the time of the Atlantic collapse over 87% of the Bank's capital was invested in them.

Hugo Oppenheim also bought shares of Analogue Controls Inc. through its grandchild corporation Trans Commercial Acceptance. A letter to it from the latter, dated March 30, 1965,³ refers to a purchase of 4,000 of these shares at 6 $\frac{3}{8}$ amounting to \$25,500 "as instructed by Mr. Tramiel". It asks for a cheque for \$12,750 as 50% margin and says that, upon payment of the difference, the shares would be forwarded. Entry No. 49 on page 15 of the general journal of Trans Commercial Acceptance for 1965 makes it plain that these shares belonged to Tramiel, and that by selling them he obtained credit of \$25,500 against total loans to himself from Trans Commercial Acceptance of something in the order of \$67,000. Four additional purchases of Analogue shares were also made by Trans Commercial Acceptance for the account of Hugo Oppenheim und Sohn in April and May of 1965, amounting in all to 5,500 shares at prices ranging between 6 $\frac{3}{8}$ and 6 $\frac{3}{4}$,⁴ the final pur-

¹Exhibit 2243.

²Exhibits 2240-1.

³Exhibit 3428.

⁴Exhibits 3429-32.

chase being recorded on May 13 of 1,000 shares which took place on the last day of trading permitted by the Toronto Stock Exchange. All these shares were provided by Tramiel and the proceeds enabled him to pay off the loan. Hugo Oppenheim und Sohn made two payments to Trans Commercial Acceptance in April, one in the amount of \$50,187.50 on April 15 and the second of \$15,000 on April 28, paying for all of the shares of Analogue purchased up until the end of that month. No payment was made for the 1,000 recorded as having been purchased on May 13, for which the Bank would have been charged \$6,750. The books of Trans Commercial Acceptance indicate that the company should have in its possession, or under its control, 9,500 shares of Analogue held for the account of Hugo Oppenheim und Sohn. But at the time of the Atlantic collapse it had none and the trustee has been unable to find any. The Arthur Andersen report for 1965 states that the Bank had instituted an action for damages against its former majority shareholder for unlawful practices, and recites the fact that instructions had been given to Trans Commercial Acceptance to sell 7,000 shares of Analogue in early May when they were quoted at \$7 per share, that the last sale of the shares was made by Trans Commercial Acceptance on May 12 and that 7,850 shares owned by the Bank, and in safekeeping with Trans Commercial Acceptance, were not found there after the latter company had been declared bankrupt. There was a settlement of this action in 1966, as will be seen. There is no record of any sale of shares by Trans Commercial Acceptance, or of any receipt for money in connection with them. There is also no record of any instructions given by Hugo Oppenheim und Sohn to Trans Commercial Acceptance to sell them, nor any record in the books of Trans Commercial Acceptance that the shares were ever delivered to it in the first place. Finally, it has not been possible to reconcile the difference between the 8,500 shares actually paid for by Hugo Oppenheim und Sohn and the statement in the Arthur Andersen report that there were 7,850 shares in the possession of Trans Commercial Acceptance.

Tramiel's Evidence

In fairness to Tramiel portions of his explanation of this extraordinary transaction should be given. Counsel began by putting a question to him giving an outline of what happened according to the evidence.¹

"Q. Evidence was given before the Commission generally to the effect that between the months of March, and including the month of March, up to the middle of May, 1965, Trans Commercial Acceptance Corporation Limited recorded the acquisition of a number of shares of Analogue Controls Incorporated, and treated this acquisition as being one which

¹Evidence Volume 86, pp. 11777-80.

Trans Commercial Acceptance was carrying out for Hugo Oppenheim und Sohn Berlin. Hugo (Berlin), according to the evidence before this Commission, paid for these shares by remitting moneys to Trans Commercial Acceptance, and Trans Commercial Acceptance credited those moneys against a loan which you had owing to Trans Commercial Acceptance; after the loan was fully discharged they set up the balance as a sum which Trans Commercial owed to you.

I put it to you, Mr. Tramiel, that the evidence is that Trans Commercial Acceptance does not have the Analogue shares, Mr. Wirth does not, the Trustee does not have them, and Hugo Oppenheimbank (Berlin) does not have them. Can you describe this transaction and tell us where the shares are?

A. The only one that I can help you with, Mr. Shepherd, is with 3,400 shares, I believe.

Q. Yes?

A. Which was in Goodfellow, in Barrett, Goodfellow Company, my personal account.

Q. Those are 3,400 Analogue shares owned by you?

A. Yes.

Q. And pledged at Barrett, Goodfellow on a margin account?

A. Yes, sir. And those shares supposed to be transferred to Trans Commercial.

Q. Tell me how the transaction arose in the first place? Why is Hugo (Berlin) buying those Analogue shares through Trans Commercial?

A. Why Hugo (Berlin) is buying to Trans Commercial, I couldn't answer. The only reason why they would buy anything, this was a Canadian stock, and they would buy it through one of their companies. At that time Trans Commercial was a company belonging to Hugo (Berlin).

Q. Yes?

A. When this request came in—

Q. Which request is that?

A. To buy Analogue shares.

Q. A request from Hugo (Berlin) to whom?

A. Trans Commercial.

Q. Who at Trans Commercial would deal with this?

A. Mr. Draper. Mr. Draper told me he received this request, and he asked me if I knew somebody who wanted to sell Analogue stock.

Q. Yes?

A. At that particular time I went to see Mr. Morgan. And I bought from Mr. Morgan I believe eleven hundred or a thousand shares. And I paid him for it.

Q. Yes?

A. I think that you—Mr. Wolfman got the cancelled cheque from me. I think it was \$7,000 or \$6,000, something of this nature. He told me, also, any more shares I would need I can buy from him.

I have also bought a certain amount of shares from Goldsmith. His wife was very sick. He was secretary, I believe, in Commodore, or treasurer, and also in Analogue. And I bought some shares from them, \$6 and change.

Q. Is that 500 shares?

A. I couldn't remember, could be 500 or more.

Q. Was Mr. Goldsmith an accountant in the United States?

A. The company, he was working for Commodore, an internal accountant.

Q. Yes?

A. I bought 500 shares from him. And then my intention was I sold to Trans Commercial 3,400 shares I had in my account.

Q. Yes?

A. The rest of the shares was supposed to come that I would buy from Mr. Morgan to make up the balance."

After further questioning, in which Mr. Shepherd took Tramiel over this ground, the examination proceeded as follows:²

"Q. I would really like to know, Mr. Tramiel, where are the shares?

A. The only accounting that I can give you is the thirty-four hundred shares the eleven hundred shares were definitely turned over to Mr. Draper, and also 500 shares that I got from Mr. Goldsmith.

Q. Yes?

A. Those are the only shares in question.

Q. What are the shares which were pledged with Barrett Goodfellow against your margin account doing still so pledged after they have been sold to Hugo Oppenheim (Berlin), why weren't they paid for and delivered to Hugo (Berlin)?

A. The day they were sold, Mr. Shepherd, I am not sure what the stock was, but the following day or the second day when I was transferring them—because my account, I didn't borrow very much against the whole account at that time, the amount of security that I had, I had some Commodore shares and Commodore debentures and some Atlantic stock, so I could have taken it out with no money at all. But I think the following day or the second day was when Analogue was delisted and the stock went down to 25 cents, and the whole thing was just in a chaos.

Q. My recollection is, Mr. Tramiel, that it was only a thousand shares which were said to have been sold on the 13th of May, or whenever

²Evidence Volume 86, pp. 11782-6.

it was, the day immediately before the delisting, and I would suggest to you that deliveries should have been made much earlier than that. And I suggest further that in any event on the over-the-counter market Analogue retained some value in the order of two to \$4.00 for a week or more. Can you assist me on those points?

A. No, I could not assist you on those points. There was no reason in any way from my side to hold back from the delivery of those shares, Mr. Shepherd.

Q. Except they were pledged with Barrett Goodfellow and you would have had to pay to get them out of pledge?

A. No, sir. I think you have my account from Barrett Goodfellow?

Q. Yes.

A. And if you look you will see I could have taken it out with no money at all. And number two, again—I am not sure, like I say, how it went, but I know there was some money, whether it was from this money or not, Mr. Morgan immediately knew I have sold those 3,400 shares, and how he found I just don't know. He immediately came up with this transaction if I can help him out and buy some Atlantic stock.

Q. Yes?

A. And I bought some Atlantic stock for it. How he got the information back immediately that this would happen, I still don't know to this day. Made sure I didn't wind up with any money.

Q. How did Hugo (Berlin) come to decide they should buy Analogue shares, do you know?

A. This point, Mr. Shepherd, I, after the annual meeting, or even before the annual meeting of Analogue, not knowing then exactly what Analogue was going to do, I was asked by Mr. Wirth what my opinion is about Analogue. And I told him I didn't know very much about it, and my recommendation would be not to sell the stock, only to sell the stock if a customer requests for cash, not to go in margin accounts, whatever they call it in the bank.

When he got this request—when Trans Commercial got this request I asked him again. And he mentioned this, have customers. I think it is in the minutes of the company away back I recommended to Mr. Wirth not to buy for his own account Analogue shares.

Q. If Hugo (Berlin) wanted to buy Analogue shares why didn't they just buy through a broker?

A. Maybe one is Trans Commercial owed them money, and it was a wholly owned company.

Q. Trans Commercial was a wholly owned subsidiary of Hugo (Berlin) at that time?

A. Yes.

Q. Can you tell me why Mr. Wirth didn't telephone his broker in Berlin? There were thousands of shares of Analogue being bought in Berlin.

A. I believe Mr. Wirth always bought through Trans Commercial or somebody in Canada directly.

Q. Were his instructions to Mr. Draper simply to buy Analogue shares or your shares?

A. Buy shares.

Q. Why didn't Mr. Draper phone his broker and buy shares listed on the Toronto Stock Exchange?

A. I moved back to Toronto on March 18th—

Q. Yes?

A. —of 1964. I was in the office, and any telegram that came in from Germany he usually told me about it.

Q. Do you mean 1965, Mr. Tramiel?

A. 1965, I am sorry. Any telegram coming in from Germany, or anything, he mentioned it to me. He asked me, 'Do you know where I can buy them?' And I told him, 'I will find out for you where you can buy them.' That is the time I went to Morgan and told him about that transaction, about that particular amount of shares. And I bought the shares from him. And repeating again, paid for them.

I didn't take them out from my own account then, the first shares.

And then, when he did find out I sold the shares from my account he immediately came up with the shares of Atlantic. So, in some way, he always had a way of making sure I wouldn't be left with any money.

Q. In this case, Mr. Tramiel, I put it to you it was Hugo (Berlin) who was being left without shares. You had the money, in a sense, they had paid to Trans Commercial Acceptance. They didn't have the shares. That is what is troubling me.

A. If I had the shares in Barrett, Goodfellow's account before the collapse it was only a matter of transferring them to Trans Commercial. When this delisting happened, and this whole thing happened, the whole thing started to be confused. And guessing why it was done, and how it was done, I couldn't answer you any more.

Q. Have you told the whole truth as far as you know it respecting the failure of Trans Commercial Acceptance or Hugo (Berlin) or the trustee to have possession of the share certificates which you sold to Hugo Berlin through Trans Commercial Acceptance?

A. I told you the complete truth, what I know of the transaction and where the shares could be."

Wolfgang Wirth's Account

Since it was afterwards contended by officers of Hugo Oppenheim und Sohn that most of Jack Tramiel's activities as chairman of its board had been unauthorized, and investments made largely without their

knowledge or consent, the recollections of Wolfgang Wirth as to what transpired in this period of 1965 are important. It should be remembered that Wirth was not expert in the use of the English language. Both Tramiel and Kapp spoke German, Kapp rather better than Tramiel according to Wirth, and these two were the latter's principal channel of communication with the Bank's Canadian interests. Tramiel and Kapp alternately visited Berlin and Kapp apparently acted as peacemaker after Wirth's abrasive contacts with Tramiel. In the interview with Wirth at Nuernberg on August 1, 1966 Mr. Shepherd's questions and Wirth's answers were in most cases translated by Mr. von Herrmann, and thus a reasonably accurate impression of what Wirth, still at that time general manager of the Bank, had been aware of under the Tramiel regime was obtained. He said that Tramiel was in Berlin in February, 1965 and, as chairman of the board of Hugo Oppenheim und Sohn, asked for three things: first, authority to establish a subsidiary of the German bank in the United States by way of power of attorney; second, authority by power of attorney to buy and sell securities in Canada for the Bank; and third, two signed cheques in blank drawn on the Bank's account with British Mortgage & Trust Company. The two cheques were obtained and the manner in which one of them, signed by Wirth and Frau Ehliitt, who had power of procuration, was used in the purchase of 1,250,000 shares of Lucayan Beach Hotel and Development Limited for \$3,780,000 in Canadian funds has already been alluded to in Chapter IX,¹ as have Tramiel's representations that he was a big business man, that the two cheques would be used so that his own name would not appear in his international transactions and that, since the Bank only had credit for a few hundred dollars with British Mortgage & Trust, the latter would never pay more than the credit balance on a blank cheque. It has also been observed that Wirth contended that Tramiel was at no time authorized to pledge the Bank's credit for \$3,780,000, which was the effect of the payment into its British Mortgage & Trust account of that amount by Commodore Sales Acceptance. Doubt has already been expressed in Chapter IX as to Wirth's assertion that he received no advice from the Crown Trust Company that it was issuing these shares to Hugo Oppenheim und Sohn, and it must again be repeated here. Hochgraeber, who had never heard of this investment made in the Bank's name, said that he had drawn the minutes of meetings of the board of directors during the period and they contained no reference to it; but he added that Tramiel was in effect the sole owner of the Bank and according to German law the chairman of the board had a right to make arrangements with the general manager. The Arthur Andersen & Co. report for 1965 apparently refers to this transaction as follows, under the

¹pp. 563-4.

heading, "Agreements and pending litigation of sufficient significance that it might detrimentally affect the financial position":

"On February 12 1965 the Bank's executive granted its then Chairman of the Board of Directors, Mr. Jack Tramiel, a power of attorney to buy and sell securities in Canada and the U.S. on behalf of the Bank. In response to the Bank's demand dated July 23 1965 Mr. Tramiel returned this power of attorney on 3.8.1965.

After Trans Commercial Acceptance Ltd. went into bankruptcy the Clarkson Company Ltd. in its capacity as trustee in this bankruptcy asserted claims against the Bank of about \$US 3,500,000. According to information received from the Bank's executive this claim is based on transactions in securities carried out by Mr. Tramiel on behalf of the Bank. Mr. Tramiel had borrowed funds for the performance of these transactions, again on behalf of the Bank. The Bank only became aware of these transactions on receipt of the Trustee's notification. The executive is of the opinion that the above power of attorney did not authorize Mr. Tramiel to borrow funds in the Bank's name. The legal position is very confused and could not be clarified within the framework of our audit."

In the event Hugo Oppenheim und Sohn did not pay any part of its debt of \$3,780,000 in Canadian funds to Commodore Sales Acceptance, if this is what the report is referring to, because it entered into an agreement with the trustee whereby the latter waived its claim and the Bank surrendered its right to the shares of Lucayan Beach Hotel and Development.

Disquiet in Berlin

As this feverish period in the history of Hugo Oppenheim und Sohn wore on, Wirth and Tramiel's fellow members of its board of directors von Rheden and Hochgraeber, had growing doubts about the good faith of their chairman. It was clear that he was not interested in the promotion of normal banking business, and Hochgraeber said that Tramiel studied the German banking regulations with the greatest care to ascertain the extent of the bank's borrowing powers. Although they had never heard of Evermac Office Equipment Company prior to the collapse of Atlantic, they began to suspect that Tramiel's massive investment in the capital of the bank was not his own money, and that he would find some way of withdrawing it at short notice and without any warning to them. Tramiel had made no secret of his connection with C. P. Morgan, telling them that the latter was the financial head of his combine and he, Tramiel, was the manufacturing head, but they felt that the extent of the Bank's investment in shares of Atlantic Acceptance was ominously large. Before the annual meeting of the Bank held on June 9, 1965 its management was greatly concerned because of the expected presence there of

members of the Central Banking Authority; Wirth expressed alarm at the Bank's lack of liquidity and its heavy foreign investments. He acknowledged that Tramiel was very calm and skilful, speaking words of reassurance to the effect that he would "unwind" the Atlantic share transactions and allow management to get on with the general banking business. Von Rheden recalled receiving an urgent call from Wirth to come to Berlin because of disquieting reports of impropriety made by employees of Arthur Andersen & Co. and when he arrived, apparently on the day before the annual meeting, found Tramiel in an angry mood. Tramiel had called the accountants and had received a denial that any such statements had been made; however, in a conversation at the Hilton Hotel he had appeared upset and nervous. When, finally, the news of Atlantic's default reached Berlin, Wirth had called Tramiel in Winnipeg where he was closing the deal to purchase Willson Stationers. Tramiel had invited Wirth to see him in Winnipeg, but the general manager had said that this was such a critical juncture in the Bank's affairs that Tramiel, as chairman of the board, should come to Berlin. Tramiel went, and was once more in control of himself and of the situation. In view of his commitments to Traders Realty in the purchase of Willson Stationers, and to Hugo Oppenheim und Sohn in the form of a personal guarantee of the continuing value of Atlantic shares at \$18 per share, it must have been a trying time. The Arthur Andersen report described the situation in its translated text as follows, under the heading of "Abandonment of the Bank's Canadian interests".

"Towards the end of 1964 and up to July 1965 the Bank had invested most of its capital in Canadian assets. These assets pertained to a group of enterprises with which Mr. Jack Tramiel, majority share holder of the Bank, was closely associated. Part of these enterprises went into bankruptcy in July 1965. The remaining enterprises suffered substantial losses as a result of this bankruptcy which in turn caused their shares to drop off sharply and, so far, permanently.

Also the Bank's Canadian assets (see p. 4 of the orig. text) suffered a serious depreciation as a result of these events. As the Bank's executive informed the auditors it then demanded payment from Cimcony Ltd. for the 81,500 shares in Atlantic Acceptance Corp. Ltd., Toronto which the Bank had sold to Cimcony on 23.4.1966, that is to say with a closing date of 23.4.1966. (Please refer to p. A 14 of the orig. text of last year's auditor's report.)

As the executive informs us Mr. Jack Tramiel personally guaranteed payment for the 81,500 shares in Atlantic at a price of \$18 each (equal to the price paid for the stock by the Bank). By way of collateral Mr. Tramiel also pledged his shares in Hugo Oppenheim & Sohn Nachf. Berliner Privatbank AG (DM 8,127,500.00) to the Bank. However, the last available quotation (on 9.7.1965) was only \$Can 1.25 per share. When it turned out that Cimcony was insolvent the Bank's executive demanded that Mr. Tramiel honour his pledge. Pur-

suant to the agreement of July 1 1965 Mr. Tramiel then undertook to sell the Bank's shares in his possession (face value DM 8,127,500.00) to the Bank, on condition that the Bank's capital stock would be reduced by the amount mentioned by way of a regular and orderly reduction of capital (cancellation after re-acquiring own stock) to be resolved at an extraordinary shareholders' meeting convened at the earliest date. The price to be paid for the stock consisted of the securities listed on p. 4 of the orig. text. By way of guarantee a trust agreement was concluded on the same day (July 1 1965) whereby Mr. Tramiel transferred his shares (face value DM 8,127,500.00) and all rights therein to Mr. Edgar Hochgraeber, solicitor, as trustee. At the same time this trustee was specifically authorized to represent these shares at the meeting of shareholders, exercise the full voting right, and sell same to the Bank.

On July 16 1965 the Bank purchased the aforesaid shares having a face value of DM 8,127,500.00 from Mr. Edgar Hochgraeber in his capacity as trustee acting on behalf of Mr. Jack Tramiel. In return, the Bank sold to Mr. Hochgraeber the canadian securities listed on p. 4 (orig. text) the effective date of this transaction being the day following a delay of 6 months in accordance with par. 178 of the Stock Act. If and when the securities sold are claimed under the provisions of par. 178 of the Stock Act Mr. Tramiel will have no claim for performance on the part of the Bank.

The necessary resolution to reduce the Bank's capital was passed by the extraordinary shareholders' meeting of July 16 1965."

Hugo Oppenheim und Sohn and Tramiel Agree to Put the Clock Back

Thus, in simple terms, Hugo Oppenheim und Sohn agreed to give back to Tramiel all of its Canadian securities in exchange for his 81% interest in its own shares. This arrangement was embodied in an agreement dated July 1, 1965, the translation of which, prepared in Toronto by the Dominion Translation Bureau and dated July 10, 1965, was offered in evidence.¹ It was executed by Tramiel, Wirth and Lange and contains the following illuminating recital: "The contracting party of the first part is a shareholder of the contracting party of the second part. He owns shares in the nominal value of DM 8,127,500 (eight million, one hundred and twenty-seven thousand, five hundred German Marks). He assures that these shares are his freely disposable and unrestricted property totally unencumbered by rights in favour of third parties." When this was put to Tramiel before the Commission, he characteristically commented "How they put it I don't care", and no doubt at this time of crisis he did not, in spite of his execution of a declaration of trust in favour of Evermac Office Equipment Company, apparently on February 16, 1965.² The agreement specifically refers to 111,900 shares of Atlantic Acceptance described as "located at Oppenheimbank Canada Ltd."; 1100 shares of Atlantic Acceptance "located in the safe of the

¹Exhibit 3426.

²Exhibit 989.1.

contracting party of the second part"; all of the common and preference shares of Commodore Business Machines for which Hugo Oppenheim und Sohn claimed it had paid Evermac, but the certificates for which it had not received, together with all its other Commodore Business Machines securities, most of which were in its own safe or expressed to be located at Hugo Oppenheimbank (Canada); and all the issued shares of that subsidiary company. It concluded in respect of all these: "stocks or securities which have been executed or disposed of by those in charge of safekeeping or by third parties, be it rightfully or otherwise, or which will be alienated after concluding this agreement, shall be deemed to have been surrendered to the contracting party of the first part." All of the securities thus relinquished by Hugo Oppenheim und Sohn were turned over to the Clarkson Company Limited by Tramiel, except those which had been pledged and sold off as security for loans, and, specifically, it acquired possession of all of the Commodore Business Machines shares and debentures. As recounted in the Arthur Andersen & Co. report, at an extraordinary general meeting of the shareholders of Hugo Oppenheim und Sohn on July 16, 1965 it was resolved to purchase Tramiel's shares in the Bank from his trustee Dr. Edgar Hochgraeber—a proceeding which would not have been permitted in Canada—and to reduce its capital by a corresponding amount.

Settlement of the Bank's Action Against Tramiel

A further settlement between Tramiel and Hugo Oppenheim und Sohn was reached in the spring of 1966 with respect to an action brought by the Bank against its former chairman in the Berlin courts. It appears to be contemporaneous with the settlement reached between the Bank and the Clarkson Company Limited with respect to the indebtedness created by the former's purported purchase of 1,250,000 shares of Lucayan Beach Hotel and Development. An agreement drawn in the German language, and described as supplementary to the agreements of July 1, 1965, was executed by Wirth on behalf of the Bank in Berlin on April 29, 1966, and by Tramiel in Toronto on June 10 of the same year; and its English translation,¹ after reciting the separation of interests between the parties of the previous year, sets out the particulars, if not the details, of an action brought by the Bank against Tramiel in November 1965, the obtaining of an attachment order and its execution against such claims as Tramiel may have had against his trustee Edgar Hochgraeber, and provides that, in consideration of a payment of DM 30,000 by Tramiel, the action will be discontinued and the attachment order vacated. Tramiel also was to pay costs. The agreement is silent as to the cause of action, except to say, "the claim lodged with the action rests on

¹Exhibit 3427.

an unlawful act by the party of the first part as manager of Trans Commercial Acceptance Limited." It further specifies "a claim arising out of a personal account of the party of the first part with the party of the second part." It may be assumed that it arose out of the apparent conversion of the shares of Analogue Controls purchased by Hugo Oppenheim und Sohn as heretofore described. Its importance, however, resides in the fact that, as mentioned in the Arthur Andersen & Co. report for 1965, it was a prerequisite to success in the action to establish that Tramiel had been a director of Trans Commercial Acceptance at the material time. As to this the agreement recites as follows:

"The party of the first part has through testimony by the notary and attorney Mr. Irvin Singer, Toronto proved that at no time in the past two years has he been manager or member of the Board of Directors of Trans Commercial Acceptance Limited. The said notary maintains in this capacity the registry files of Trans Commercial Acceptance Limited in which the conditions of representation are recorded."

In fact the minutes of Trans Commercial Acceptance² show that Jack Tramiel was both president and a director of the company until September 14, 1964, or only some nineteen months before the date of the execution of the agreement in Berlin, if one accepts the minutes of a directors' meeting for that date which record a resolution accepting his resignation as president and director and go on to say that he left the meeting, somewhat pointedly, as it may be thought. The minutes of the next meeting on October 14, one month to the day after its predecessor, record the presence of Kapp, Draper and Solomon only, but under the words "Manfred Kapp" it is clear that a name has been erased. The facility with which minutes and other documents have been prepared, when required to sustain an argument or mislead investigation has called for frequent comment in this report, and it may be significant that no notice of this resignation was given to the Department of the Provincial Secretary as required by law, and no return under the Corporations Information Act as at March 31, 1965 was filed. Then again, if the minutes are accurate it is unlikely that the time material to the action ante-dated September 14, 1964.

Analysis of Financial Information, 1963-65

Using the compendious reports of Arthur Andersen & Co. on the affairs of Hugo Oppenheim und Sohn for 1964 and 1965, which also gave comparative figures for 1963, Mr. Lord prepared condensed comparative balance sheets for each of the three years ended December 31 which are shown in Table 50,¹ with eight schedules as follows: (1) Statement of Profit and Loss for the year ended December 31, 1964, (2)

²Exhibit 296.

¹Exhibit 3433.

Analysis of Securities Trading Profits for the same year, (3) Analysis of Commissions Earned for the same period, (4) Statement of Profit and Loss for the year ended December 31, 1965, (5) Continuity of Share Capital December 31, 1963 to December 31, 1965, (6) List of Shareholders and Directors as at December 31, 1963, (7) the same for the year ended December 31, 1964 and (8) the same as at December 31, 1965. In the year 1963, which was the last full fiscal year before the introduction of Atlantic money, the Bank's assets consisted of call loans, ordinary bank loans and other sums, the greater part of which were cash reserves required to be kept by German banking regulations, all in the aggregate amount of D.M. 3,662,300. The liabilities were sums owing to depositors divided into sight deposits and other loans payable. The subscribed capital amounted to D.M. 1,500,000, and at December 31, 1963 it had been impaired to the extent of D.M. 682,900, leaving shareholders' equity at D.M. 817,100. The profit and loss statement for 1964 shows comparative figures for 1963 indicating that the loss for the earlier year was D.M. 345,800. Loan and other banking business produced 95% of the revenue and the remainder came from commissions earned in the trading of securities.

A marked change appeared in 1964. Total assets were D.M. 13,385,600, of which approximately D.M. 9,148,000 is represented by securities mostly of Atlantic Acceptance and Commodore Business Machines and loans to Trans Commercial Acceptance and others, together with an investment in the new subsidiary Hugo Oppenheimbank (Canada), which in turn held securities of Atlantic Acceptance and Commodore Business Machines. The liability side of the balance sheet figures for 1964 provides the explanation for the large increase in the order of 300% in the bank's assets by showing an increase in capital of D.M. 8,500,000, of which D.M. 8,127,500 came, as has been seen, from Atlantic Acceptance through various hands, including those of Jack Tramiel. A figure which is shown as having risen substantially on the liability side is that of loans payable, and two new sources of loans to the bank were provided by Trans Commercial Acceptance and O'Brien & Williams, the second being the debit side of a margined brokerage account secured by a pledge of Commodore Business Machines securities belonging to the Bank. Sight deposits, added to other banking liabilities which may be compared with the 1963 figures, show a general decline of 10%. The decline in the deficit from D.M. 682,900 to D.M. 328,600 resulted from the net profit of D.M. 354,300 reported at the end of 1964 which may be compared with a loss of D.M. 345,800 for the previous year. The profit and loss statement also shows that, whereas loan and other banking business produced 95% of the bank's total revenue in 1963 and securities business only 5%, in the year 1964 the position was sharply reversed, only 20% of the total revenue being attributable to

loan and banking business and 80% to securities business. The securities transactions were mainly in the shares and obligations of Atlantic Acceptance and Commodore Business Machines, and the loan and other banking business remained substantially unchanged at D.M. 250,000 in absolute terms. The supporting schedule entitled "Analysis of Securities Trading Profits" shows four main transactions: first, the purchase and sale of 100,000 common shares of Commodore Business Machines, second, the purchase and sale of 100,000 preferred shares of Commodore Business Machines, third, purchase and sale of \$1,000,000 in par value of Commodore Business Machines debentures and fourth, purchase and sale of 38,500 common shares of Atlantic Acceptance. The recorded profit from these transactions was D.M. 844,876 which, after deduction of small losses relating to other transactions in the amount of D.M. 5,176, produced a net yield of D.M. 839,700. The revenue derived from commissions amounted to D.M. 38,700 in 1964 as compared with D.M. 6,100 in 1963, and of the former amount D.M. 34,097 was derived from one "option payment" made in December 1964 by Cimcony Limited of \$9,219.69, provided for under the agreement to purchase from the Bank the remaining 81,500 shares of Atlantic Acceptance. Dividends received in 1963 were a mere D.M. 2,200 but in 1964 were D.M. 89,900, most of which consisted of those paid on 120,000 shares of Atlantic Acceptance on November 30 of that year.

Looking again at the balance sheet figures for 1965, it is clear that the assets related to the banking business are much what they were in 1963, with the exception of a new investment of D.M. 650,000 in an automobile finance company. The liabilities to outsiders are higher, and the total shareholders' equity at the end of 1965 of D.M. 876,500 may be compared with D.M. 817,100 in 1963, as against D.M. 9,671,400 for 1964. The modest increase in value of shareholders' equity at the end of 1965, compared with its value at the end of 1963, is, however, illusory in the sense that it is explained by the shareholders having been required to invest new capital in the amount of D.M. 376,500 to offset the impairment suffered in 1965, together with the cancellation of the shares representing the investment of Atlantic money. If this had not been done, the shareholders' equity would have been shown as having declined to approximately D.M. 500,000. In spite of the infusion of a sum in excess of D.M. 8,000,000 from the Atlantic investment, there is no substantial increase in liquidity at the end of 1964 over the position at the end of 1963, because this money was at once invested in shares of Atlantic Acceptance and Commodore Business Machines. If there had been no trading in these shares, Hugo Oppenheim und Sohn would have suffered another loss in 1964. The profits which the Bank recorded from this trading were more than offset by losses suffered as a direct result of

the Atlantic collapse; as a result of the brief but tempestuous relationship with Jack Tramiel, and involvement in the affairs of Atlantic Acceptance, it was in a decidedly worse position than before he had appeared on the scene.

Concluding Reflections

Hugo Oppenheim und Sohn was a private bank and not a particularly substantial one by German standards. Many of the German private banks like it, and like the Maerklin Bank in Frankfurt-am-Main, are little more than investment dealers with deposit-taking functions which are none the less subject to strict regulation. For this reason stock-brokerage concerns, as we know them, are generally absent from the German financial scene. Considering the scale of its operations, even had they been profitable in 1963, it is hard to resist the conclusion that Morgan and Tramiel mistook the function of the Bank as a source of substantial borrowings in the German capital market. It did, indeed, fulfil the immediate purpose which was prescribed for it by its new owners, enabling them to conceal from the directors of Great Northern Capital Corporation the real source of the money with which 120,000 common shares of Atlantic were purchased, and which compelled them to match the investment in order to retain control of their subsidiary. Not only was Atlantic Acceptance able in effect to buy its own shares with its own money, but that money was used to obtain at the same time absolute control of the affairs of the Bank, and the Bank itself was compelled to execute indirectly a transfer of the shares into the hands of Cimcony Limited, a company which could not have qualified as a purchaser in an exempt transaction under the rules of the Toronto Stock Exchange and one-fourth of which was in the hands of a Bahamian corporation owned absolutely by C. P. Morgan. The part played by Jack Tramiel, the president of a company which owned a substantial and profitable subsidiary manufacture in West Germany, was consistent with all the conduct so far described in this report. Not only did he fail to disclose to his colleagues in the German bank that their enterprise was being used as a prop on the stage of Morgan's clandestine financial operations, but he represented on several occasions that the overwhelming interest which he held in the stock of Hugo Oppenheim und Sohn was his personal holding, free and unencumbered of any trust relationship or other obligations, as he represented to the Traders group that the 75,000 shares of Atlantic Acceptance pledged by him and Kapp in the Willson Stationers transaction were their own freely disposable property. The full measure of Tramiel's unconscionable and persistent dishonesty is perhaps best illustrated by the part he played in supplying shares of Analogue Controls to the institution over which he presided, and which he did not

scruple to deceive again in the settlement of its action against him in the spring of 1966. To all the questioning on the subject of these transactions he had one consistent and, indeed, monotonous answer; that was to the effect that Morgan knew all about what was going on and that he at every step acted on Morgan's instructions. It is more than likely that Morgan did know what Tramiel was doing, but in many cases not until after it had been done, and much as he may have wanted to be the prime mover he often found himself toiling in his partner's wake.

On the other hand, the version of the relationship between Hugo Oppenheim und Sohn and Jack Tramiel given by von Rheden and Wirth to Arthur Andersen & Co., and no doubt to the Central Banking Authority in Berlin, is an over-simplification of conduct which was not as ingenuous as it has been made to appear. The opportunity to make quick and badly-needed profits, extended by Tramiel and Morgan, was sufficient to induce them to comply with suggestions which they knew to be improper, of which the furnishing of two blank cheques to Tramiel was an example on the part of Wirth. As for von Rheden, he appears to have been a mere amateur in business, to have genuinely liked C. P. Morgan and his wife, if not Tramiel, and to have been much under the spell of the rainbow's end in Grand Bahama. As a concluding note to Wirth's interview, and a suitable one for this chapter, he described how, shortly after he and von Rheden had returned from Toronto in December 1964, Frank Kaftel telephoned him from Paris saying that he had learned that Wirth had been unable to secure a listing on the Berlin Stock Exchange for the shares of Commodore Business Machines, and that he, Kaftel, would come to Berlin and show him how to do it. He arrived with a secretary in Berlin on the following day and, according to Hochgraeber, only succeeded in having the shares listed on the "free market" through a broker named Seydlitz. Wirth said that he had told Tramiel, when he next saw him, that Kaftel was "a gangster", to which Tramiel replied that occasionally it was necessary in business to deal with people of that type. If this conversation actually took place, Wirth must then and there have lost his last illusion as to the quality of the man who had become his chief, but who thereafter asked for and received from the general manager, vested as he was with unchallengeable authority in such matters by German banking law and custom, two blank cheques.

CHAPTER XI

Racan Photo-Copy Corporation

Elias Yassin Rabbiah

Racan Photo-Copy Corporation Limited was incorporated as a private company in Ontario on May 6, 1960. Its promoter was Elias Yassin Rabbiah, a man who attained considerable notoriety in Toronto between the years 1962 and 1965, and landed there with his wife in 1956. His brother Anwar was also an immigrant in that year but subsequently moved with his family to the United States. How the Rabbiah brothers came to be admitted to Canada might well provoke inquiry; at least the attempts of Elias to become a Canadian citizen have been unsuccessful. Police and diplomatic records indicate that he was born at Baghdad in Iraq in 1923, but on his arrival in Canada he was in possession of a Lebanese passport expressed to have been issued by the "Consula du Liban" at Johannesburg in South Africa¹ according to the impression of a rubber stamp beside, and partially superimposed upon a photograph of the bearer. Although this passport on its face was valid for one year, an extension appears, dated November 9, 1956, stamped with a seal reading "Consulate General of Lebanon, Sydney", and a further extension from November 7, 1957 for one year evidently came from the Lebanese Legation at Ottawa on July 16, 1957. The passport was issued in the name of Yassin Souleman Rabbiaah, Souleman being the name of his father, and a successor to it was issued in Ottawa by the Embassy of Lebanon on December 26, 1958 and renewed annually to July 3, 1965.² The Lebanese passport ultimately held by Rabbiah was issued at the Honorary Consulate in Toronto on April 14, 1964 and has since been seized by the Royal Canadian Mounted Police. On August 16, 1966 the

¹Exhibit 4011.

²Exhibit 4012.

Chargé d'Affaires for Lebanon at Ottawa wrote to Mr. H. C. McGuire of the Ontario Securities Commission, who testified as to all these matters before the Commission on February 22, 1967,³ denying that "Elias Salman Rabiha" was a Lebanese national and asserting that the passport in his possession must have been obtained by fraudulent means. Subsequent reports from the police in South Africa indicate that the Lebanese consulate was not opened in Johannesburg until 1959 and that Rabbiah gave a false address for his residence there. It is permissible to observe that, had an alert Canadian immigration officer noticed the mis-spelling of the familiar French word "consulat" on the document which Rabbiah presented at Malton Airport in 1956, all of the melancholy record which follows might have been dispensed with.

This thirty-three year old new arrival, of medium height, considerable corpulence and with scars on both cheeks, had other documents of identification, also found by Mr. McGuire in a suitcase which will be mentioned again. One was an identity document in Arabic, numbered 11290 and issued in Baghdad on May 13, 1939, saying that Elias Yassin Rabbiah was born in 1923 in Baghdad, the son of "Shlomo and Rosa";⁴ another is an Iranian identity booklet No. 3198 issued by the Iranian consulate in Beirut in 1954 with a photograph of Rabbiah, saying that "Elias Rabea" is an Iranian national through his father. With respect to the latter, Mr. McGuire received a letter dated August 11, 1966 from the Imperial Embassy of Iran at Ottawa, to the effect that there are signs of alteration on this document and that there are no grounds for considering Rabbiah to be Iranian. Nevertheless his brother Anwar appears to have landed in Canada bearing an Iranian "travel document", issued in Vienna on July 24, 1956.

It is remarkable that Elias Yassin Rabbiah did not display his one apparently genuine document of identity which was an Israeli passport issued in Jerusalem on July 26, 1953. The duration of this passport is not known, but on July 12, 1954 he was issued with a replacement, No. 26279, by the Israeli consulate in Milan because he claimed to have lost its predecessor. If the original passport was of one year's duration and required renewal, the fact that on the day after its issue in 1953 he was convicted by the District Court in Tel Aviv of conspiracy to commit a misdemeanour and threatening violence may have had something to do with it. This was his second conviction in Israel, since on May 21, 1953 he was convicted of selling \$17,000 in U.S. funds without the permission of the Minister of Finance.⁵ His sojourn in Italy was not apparently uneventful, because on October 24, 1958 he was convicted with Anwar, under the name of "Elie Rabiea", of "aggravated and continuous frauds

³Evidence Volume 99.

⁴Exhibit 4008.

⁵Exhibit 4014.

and fraudulent bankruptcy" in Milan, and sentenced *in absentia* to a term of seven years and eight months and to pay fines amounting to 32,000 lire. It was reported that the Rabbiah brothers embezzled funds from a company called "Clartex Fabrics" of which E. Y. Rabbiah was the sole director. Large quantities of merchandise were purchased for this company and paid for with post-dated cheques, but the company's funds were withdrawn before these were due for presentation. Little is known of E. Y. Rabbiah's activities in South Africa, save that he was reported to have operated a business called Clair's Investments in Johannesburg and was there married. His Lebanese passports contain numerous visas indicating travel in many parts of the world.

The details of Rabbiah's career, as far as they are known or reported, have been dwelt on with some particularity because they exhibit a *modus operandi* not greatly dissimilar from that employed by him in the ten years following his arrival in Toronto. He was by all accounts a mild-mannered, soft-spoken, persuasive man with considerable charm of manner. By instinct and experience he was a trader and continued to deal in foreign currency, particularly with a concern called Deak & Company, an association which involved it in considerable loss from taking post-dated cheques from Rabbiah which proved to be worthless. He operated companies called Canada Export Company and Contrading Company Limited which did everything from importing shirts from Hong Kong to exporting flour to Iraq. The origin of his participation in the fashionable business of selling office copying machines is obscure and perhaps unimportant. The business of Racan Photo-Copy Corporation was originally one of distributing the machines of other manufacturers and supplying specially-treated paper for their use, and as a result of supplementary letters patent issued in Ontario on September 21, 1962 it became a public company; the original modest share capital was expanded to provide for 40,000 preference shares without par value, already issued, and 400,000 issued common shares out of a total authorized of 4,000,000.⁶ By October 12, 1962 Rabbiah, who was president of the company and had over the preceding years gathered into his own hands 399,998 of the issued 400,000 common shares and all of the preference shares, considered that the time was ripe to offer to the public 100,000 of his common shares, and a prospectus of that date⁷ was filed with the Ontario Securities Commission, containing a financial statement as at June 30, 1962 on which the well-known firm of chartered accountants, Price, Waterhouse & Co., gave an unqualified report. The 100,000 shares were offered to the public at \$2 per share. At the end of January, 1963, they were trading over the counter at \$4.50 bid and \$5 asked, and by the end of May at \$24 bid and \$25 asked.

⁶Exhibit 268.

⁷Exhibit 271.

The Racan 1015 Dry-Copy Machine

Before tracing the connection of Rabbiah and his company with C. P. Morgan and Atlantic Acceptance it is convenient to refer briefly to the events which were known to the public, following the company's change of status and the filing of its prospectus in the autumn of 1962. Morton R. Goldhar, a public relations consultant, whose first client seems to have been Racan Photo-Copy Corporation, testified before the Ontario Securities Commission¹ that Rabbiah issued through him a series of press releases between October 1962 and February 1963, and in particular one on December 12, 1962 which recorded an announcement by Rabbiah that the company would start manufacturing a photo-copy machine for the first time in Canada, using an optical scanning process to produce a dry copy on any type of paper. This was the Racan "1015" dry-copy machine which subsequently became notorious. The figure "1015" referred to the maximum size of the paper employed and was intended, according to Goldhar, to compare favourably with the Xerox "914" machine which was well known to the trade and the public. The news that a dry-copying machine was to be manufactured in Canada, miraculously cheaper both to make and operate than anything else on the current market, drew many inquiries, including serious investigation by Xerox Corporation, International Business Machines and Minnesota Mining and Manufacturing Corporation, all leaders in the field. Racan's board of directors was graced by E. B. Hawkins, representing Wills, Bickle & Co., a well-known Toronto firm of investment dealers and underwriters, and W. O. C. Miller, a member of Blake, Cassels & Graydon, the largest and perhaps the oldest law firm in Toronto. The relatively small number of shares available for trading—250,000 of Rabbiah's remaining shares were in escrow and the balance of 50,000 pledged—reached a high price per share of \$26 in May, 1963. It was in this month that the first signs of a set-back were observed, when Rabbiah held a showing of the new machine at the Savoy Hotel in New York arranged by Goldhar. After producing two copies the machine broke down and the show, which was well attended, was a failure and received bad notices in the press. The stock declined in price, but recovered when a contemplated showing at the Royal York Hotel in Toronto, advertised for June 3, was cancelled by a press notice published on May 30 which referred to "imminent negotiations." Goldhar said that after this time his relationship with and regard for Rabbiah deteriorated rapidly, and on June 13 Hawkins and Miller resigned as directors.²

The next public showing was calamitous and might have been expected to seal the company's fate. At a shareholders' meeting in July, held at the King Edward Hotel in Toronto, to which outsiders were freely

¹Exhibit 3750.

²Exhibit 4022.

invited, Rabbiah operated the machine himself, inserting an original document and extracting from it over fifty copies. These were handed around and provoked a request from a member of the audience to operate the machine himself. This was denied, Rabbiah saying that first of all he would demonstrate a stair-climbing wheel-chair manufactured by the company's subsidiary, Belpree Company Limited, and then show a moving picture, after which any members of the audience who wanted to operate the machine could do so. At some point in the demonstration which followed the lights went out completely, and when they were turned on the machine had disappeared. No explanation of this extraordinary occurrence was apparently vouchsafed, other than to say that the factory was closing and the machine had to be returned to it. The copies made on this occasion, one of which at least was preserved, turned out to be made on sensitized rather than plain paper. Since it had been claimed that copies could be made by the Racan "1015" on plain paper and all the advance publicity had turned on this revolutionary development, disillusionment might have been expected to be complete. Newspaper comment in any event was derisive, and by July 31 the over-the-counter price was \$3.50 bid and \$4.50 asked, a drastic decline, indeed, but not overwhelming. On August 26, 1963 the Ontario Securities Commission issued an order to investigate the trading in the shares of Racan Photo-Copy Corporation by Elias Y. Rabbiah; the scope of the inquiry was later enlarged by a further order on June 16, 1965 after sensational publicity surrounding the receipt of spurious orders to buy Racan stock, amongst other securities, by a number of brokers in New York City, and which has been seen to have been a source of great distress to C. P. Morgan. The results of the investigation were made available to this Commission the staff of which had been already engaged in examining the special relationships existing between Racan and subsidiaries of Atlantic Acceptance. As it turned out, it was not to have the benefit of hearing the evidence of Rabbiah himself. On June 17, 1966 he was arrested in Toronto and charged, jointly with his associate and then president of Racan, Kenneth George Lennie, with defrauding the company of \$248,000 between March 1 and May 15, 1965, defrauding Commodore Sales Acceptance of a sum of money in excess of \$50, uttering forged cheques to the total of \$248,000, defrauding one Bruce A. Wilson of the sum of \$150,000, and with conspiracy to do all these things. Bail was fixed by a prescient magistrate in the substantial sum of \$100,000 in the case of Rabbiah who was at once afflicted by a virus infection, acquired, as he said, in the course of a visit to the Congo, and he spent the next six weeks under guard in hospital, appearing at the preliminary hearing on July 20 in a wheelchair. Both men were committed for trial at the Assizes commencing in January of 1967 on all the charges, except those connected with the alleged fraud upon Wilson, which was held to have been

committed, if at all, outside the jurisdiction. Just before the hearing opened, Mr. Malcolm Robb, Q.C., counsel for both the accused, on application to the Supreme Court of Ontario, succeeded in securing the reduction of bail in Rabbiah's case to \$30,000, a sum which he was able to post, with consequences that were regrettable in their effect on the administration of justice.

A Fugitive from Justice

The final argument at the preliminary hearing of the charges against Rabbiah and Lennie concluded on August 25 and the magistrate adjourned it for consideration until the afternoon of September 12. On that day the accused were committed for trial and in the evening Rabbiah, still in his wheelchair, boarded a New York-bound aircraft at Malton International Airport. From this he was removed by the Airport Police Detail and subsequently interviewed by officers of the Immigration and Passport Section of the Royal Canadian Mounted Police who had a search warrant for his current Lebanese passport and impounded it. He was then permitted to return to his residence at 1 Benvenuto Place, assisted by the companion who was to accompany him to New York, Arthur H. Debenham of Scarborough. Debenham left him at midnight and was the last identified person who saw him on Canadian soil. Some days later Rabbiah telephoned him from New York, saying he was in hospital undergoing treatment. The Commission's investigator was informed that the United States Immigration authorities at Malton had not interviewed Rabbiah subsequent to his removal from the aircraft, nor had they recorded that occurrence. One can only speculate on his means of entry into the United States which, in the absence of any warning given to Immigration officers, could have been easily accomplished by train or automobile at the Niagara frontier.¹

When the case of the Queen against Rabbiah and Lennie was called on January 10, 1967 for trial before Mr. Justice Hartt and a jury Rabbiah did not appear and his bail was estreated. The trial of Lennie however proceeded. Much was made by the defence of the absence of the main actor, and after deliberating for nine hours the jury found Lennie not guilty of the charges preferred against him. Speculation as to what the result would have been had Rabbiah been present and faced with what, on any reading of the transcript of evidence, would appear to be cogent evidence of guilt, is an unprofitable exercise, but the disinclination of the jury to convict a man who was clearly the pliant tool of the principal offender, if offender he was, can be readily understood. At the trial it was disclosed that Rabbiah had provided money for Lennie's defence, and the fact that he had absconded was on every lip. Thereafter

¹Commission file "E. Y. Rabbiah": Report of Detective-Sergeant Angus to the Commissioner, June 5, 1967.

the law enforcement agencies of Canada and the United States, and investigating officers of this Commission, made persistent efforts to find him. All these have so far proved to be fruitless; yet Rabbiah has from time to time issued statements through his attorneys in New York, where he is wanted on another charge, and the Commission has availed itself of the opportunity of putting questions to him through these intermediaries. Such a procedure would be regarded as bizarre in this country, and there is no example here which can be readily recalled of professional advisers being parties to the concealment of a wanted client and escaping censure. However, the law of privileged communications is much more elastic in the United States than in Canada, and it is to be hoped that the current fashion of emulating American patterns of law reform does not extend to change in this area, and the erection of another safeguard for criminal activity at a time when it has reached a level and intensity in all parts of North America which should fill law-abiding citizens with acute alarm.

The Commission is in possession of two statements, said to be prepared by Rabbiah, which were given by his New York attorneys in the first instance to the *Toronto Telegram*. Since they were reported extensively in that journal on March 30, 1967, although, be it said, with considerable discretion, and since, taken together, they constitute a farrago of libellous nonsense, it is not intended to reproduce them here. The gist of them is that everything was somebody else's fault and everything done was done under compulsion of threats against Rabbiah and members of his family. Except in one particular, which will be referred to, they are as worthless as might be expected from the manner of their transmission.

In the light of these developments, with Rabbiah a fugitive from justice and liable to face trial if apprehended, a situation of some difficulty confronted the Commission. This was referred to by counsel before he introduced the relevant evidence of the connection between Racan Photo-Copy Corporation and Atlantic Acceptance on February 22, 1967.²

"MR. SHEPHERD: Mr. Commissioner, I propose today, subject to your leave, to introduce evidence relating to the affairs of Racan Photo-Copy Corporation Limited insofar and only insofar as the affairs of that company are material to be considered in determining the causes of the collapse of Atlantic Acceptance Corporation Limited.

It was intended to introduce this evidence as early as last July, but at that time one of the persons to whom the testimony must allude, one E. Y. Rabbiah, was arrested on a number of charges, some of which, not all, related to the affairs of Atlantic Acceptance and it was thought it would be desirable to do nothing by way of introducing testimony in

²Evidence Volume 99, pp. 13502-3.

public at that time because it was feared that so to do might conceivably affect this man's right to a fair trial. And accordingly, nothing was done.

The trial was set for January and when the case was called, E. Y. Rabbiah did not appear.

Subsequently his bail was estreated and he has not yet been found. In the meantime, a warrant, as I am informed, for his arrest on another charge was issued in the United States and I do not know what has happened about that. But he has not been apprehended, nor has he surrendered himself to date so far as my knowledge extends. It may be that this man will be apprehended or surrender himself ten years from now or never or today for all I know.

Since we are now very close to the end of the public hearings of the principal matters relating to Atlantic Acceptance Corporation Limited, it seems impractical further to delay the introduction of at least some evidence indicating to what extent the affairs of Racan may be said to be the cause, one of the many causes, of the collapse of this company. Accordingly, as a choice, choosing the best of a number of unsatisfactory alternatives, I propose now to adduce evidence limited to matters already dealt with at the preliminary enquiry, which lasted many days, of the charges against E. Y. Rabbiah and another and also limited to matters which subsequently became public and were widely reported upon on the occasion of the trial of one Lennie, L-e-n-n-i-e. Since these matters have already become public, it is considered that significant damage can no longer be done by introducing evidence touching on those matters before this Commission.

It seems an unsatisfactory course. The evidence inevitably will be incomplete. But if you concur, sir, I propose to adopt this course and then other matters which have not been as yet made public may be taken into account by you in due course."

The accounting evidence concerning the records of Racan Photo-Copy Corporation, Premier Finance Corporation, Commodore Sales Acceptance and cognate matters was given before the Commission by John A. Orr, F.C.A.,³ on February 22 and February 23, 1967.

Racan's Sources of Funds

The Premier Finance Corporation was the first source of the funds of Atlantic Acceptance which found their way to Racan Photo-Copy Corporation. It will be recalled that this company had been acquired by Atlantic Acceptance on February 11, 1959 by purchase of all its shares from Clarence F. O'Neill, who continued to operate it as general manager¹ and also continued to operate a company called O'Neill Finance Company, later incorporated and owned by him, which also lent money to Racan. The history of the loans made by Premier Finance, beginning

¹Evidence Volumes 99-100.

³Exhibit 553.

RACAN

with an advance of \$152,886.40 made by cheque dated December 6, 1961,² was as follows:³

Advance	December 5, 1961	\$152,886.40
Balance	December 31, 1961	136,410.40
	January 31, 1962	186,410.40
	February 28, 1962	252,345.40
	March 31, 1962	325,275.00
	April 31, 1962	292,965.00
	May 31, 1962	248,563.40
	June 30, 1962	339,124.60
	July 31, 1962	339,124.60
	October 31, 1962	311,580.48
	June 30, 1963	312,016.46
	July 31, 1963	412,016.46
	August 31, 1963	455,016.46
	September 30, 1963	420,016.46
	October 31, 1963	423,016.46
	November 30, 1963	573,016.46
	December 31, 1963	590,721.00
	January 31, 1964	684,262.46
	April 30, 1964	699,262.46
	May 30, 1964	721,262.46
	June 30, 1964	766,955.69
	December 31, 1964	840,273.74
	January 31, 1965	813,484.67
	April 30, 1965 and June 17, 1965	788,484.67

In February 1964, when the fortunes of Racan Photo-Copy Corporation were at an understandably low ebb, loans were made to it by Trans Commercial Acceptance on a relatively small scale during a period in which Commodore Business Machines, brought on to the scene by C. P. Morgan, was managing the company under the terms of a contract whereby Racan was to pay Commodore Business Machines \$30,000 a year and which caused dissatisfaction to both parties. This period of tutelage for Rabbiah, his vice-president Alfred Weidman, a former employee of Deak & Co. whose complicity in that company's dealings with Rabbiah had caused his dismissal, and Lennie, the company's secretary-treasurer, ended after three or four months in a head-on collision with Kapp, and, after an attempt by him and Tramiel to take over Racan, was frustrated in familiar fashion by Rabbiah obtaining the personal intervention of Morgan. It followed the acquisition by Commodore Business Machines of two subsidiary companies of Racan, Belpree Company Limited and Associated Tool & Manufacturing Company Limited, for \$300,000 which was used to pay off a Racan loan owing to the Bank of

²Exhibit 4020.

³Exhibits 552, 3478 and 4019.

Nova Scotia, a burden assumed by Commodore Business Machines on guarantees which Morgan had arranged. Trans Commercial Acceptance, itself entirely dependent upon Atlantic Acceptance for funds, factored Racan's accounts receivable on a comparatively prudent scale under Kapp's direction for almost eight months, and recorded its advances to the borrower as follows:⁴

Opening entry February 17, 1964	\$ 4,045.59
March 31, 1964	50,542.82
April 30, 1964	66,185.48
May 31, 1964	55,867.45
June 30, 1964	55,504.49
July 31, 1964	59,297.56
August 31, 1964	60,579.53
September 22, 1964	62,692.07

After the association with Commodore Business Machines had ended, the Trans Commercial Acceptance loan was taken over by Commodore Sales Acceptance on September 22, 1964, and the financing of Racan came directly under the eye and hand of C. P. Morgan, who by June 17, 1965 had permitted Commodore Sales Acceptance to advance sums on a scale which, in the face of the existing loans made by Premier Finance, seems to have been abnormally imprudent, even for him. The records of Commodore Sales Acceptance reveal the following monthly outstanding balances:

September 22, 1964	\$ 62,692.07
September 30, 1964	86,992.68
October 31, 1964	106,468.12
November 30, 1964	148,286.80
December 31, 1964	240,853.84
June 17, 1965	461,188.72

The loans of Premier Finance were made against warehouse receipts, and on promissory notes in the case of some short term loans, supplemented for a time by a pledge of 50,000 Racan shares owned by Rabbiah and by his personal guarantee. Trans Commercial Acceptance held a general assignment of book debts in addition to the pledge of receivables, but when Commodore Sales Acceptance took over the loan it appears to have released Racan from the assignment and made its advances against a pledge of accounts receivable alone. These receivables, according to testimony given at the preliminary hearing of the case against Rabbiah and Lennie and before the Commission, were largely fictitious, and Racan's trustee in bankruptcy expects no recovery. At the date of the Atlantic receivership Racan owed Premier Finance and Commodore Sales Acceptance \$1,249,000 to the nearest thousand dollars,

⁴Exhibit 4021.

and the Premier Finance loan included \$200,000 assumed by it and previously owing to O'Neill's private company.

The history of these loans is the more remarkable since, from the early part of 1962 onward, Racan ceased to make payments sufficient to cover more than the accrual of interest much of which was capitalized in any event. Only two repayments of any substance were made to Premier Finance, one on January 15, 1965 in the amount of \$26,789.07 and the other on April 28 in the amount of \$25,000, but since, during the first four months of 1965, in which Racan's source of funds was almost entirely limited to Commodore Sales Acceptance, the loans made by Premier Finance declined by \$51,000 and those made by Commodore Sales Acceptance rose by \$221,000, it would appear that Racan borrowed from the latter to repay Premier Finance and the position of the Atlantic complex itself was not improved. When Morgan was examined in the spring of 1966 much of what was subsequently known had not been considered, and counsel's questions were mainly directed towards discovering his reasons for accelerating the pace of lending to Racan in 1965, when he had ample reason both from public and private sources to know that Rabbiah was dishonest and the reported assets of his company largely non-existent. It will be recalled that Morgan said that David Rush's knowledge of reckless lending of Atlantic money to Racan and Dalite Corporation put him in a position to secure favours which would not otherwise have been granted, and it was this observation that introduced the evidence which he gave to the Commission on his relationships with Rabbiah and Racan.⁵

"Q. You said that Mr. Rush had some knowledge of loans to Racan. I must put it to you that I find the loans made to Racan in 1965 unusual in that I suggest it was widely known that Racan's financial condition was precarious by the end of 1964. Can you assist the Commission as to what reason existed for making loans to Racan in 1965 or the latter part of 1964?

A. These loans were made specifically with the end in view of keeping Racan alive for the simple reason that all bank credit had disappeared and these loans were made through Commodore Sales Acceptance, through Mr. Woolfrey, on my specific instructions that no other loans except general or specific assignments of receivables be made and that they were to be, in the vernacular, watched like a hawk.

But, in spite of this, and the use of Mr. Cockburn, Frank Cockburn, who was employed by Chartered Management Consultants and was used by Woolfrey for field work, Mr. Lennie, who was the then President of Racan, was able to produce invoices that were phoney and he was able to borrow money in the usual pattern of invoices coming in and receipts being paid and then larger invoices going out, and he had created the illusion of sales activity over a period of four or five months that indicated everything was fine, but in the last analysis the invoices

⁵Evidence Volume 26, pp. 3472-7.

got larger where there were claims of shipping machines to these various customers, and when the balloon punctured Commodore again was left holding the bag on the large amount of advances.

Mr. Rabbiah had been in and had shown a new form of copying machine, which he called his 1015, and he had got some 200 of these units shipped into Toronto and they were out and being leased to Toronto businesses and on the face of it it looked like a legitimate enterprise. I, of course, was fully aware of the situation with regard to the loans at Premier which were collaterally secured by notes of Anglo Overseas Corporation, is it?

Q. Yes, some such name.

A. Which notes were in the hands of the public on the conversion of the Racan shares, and which notes had paid their interest on the 1st of December, 1964.

Q. You said that the loans were being made to keep Racan alive. Did you care whether Racan was kept alive?

A. I only cared to the extent that Mr. Rabbiah personally and Racan and Anglo Overseas were liable for the money that was owing to Premier. Yes, I cared about Racan for the simple reason that I felt that it should have been a good enterprise, and I had no personal interest in any of the shares of Racan but I did have an interest in the large amount of debt that was owing by Racan to Atlantic and associated companies.

Q. The Commodore Sales money, I take it then, was loaned in the hope that it would protect the substantial sums that had been earlier advanced by Premier?

A. That is the only reason.

Q. Were you responsible for the earlier sums loaned by Premier or were those loans made on somebody else's direction?

A. When I first became aware of the loans that Premier had made to Racan they aggregated some \$900,000. All of these loans were made by the President of Premier, who was an employee of Atlantic, Mr. C. F. O'Neill, and, strangely enough, these loans were made not only on behalf of Premier but also 50 per cent of the loan was on behalf of O'Neill Finance Corporation which was supposed to be a small finance company of Mr. O'Neill's and which he was operating when we purchased Premier from him. In this connection I think I have given evidence in connection with the bankruptcy that Mr. O'Neill eventually got paid off entirely for the advances which Racan had borrowed jointly from O'Neill Finance and from Premier.

And as a result of this transaction I did not renew Mr. O'Neill's contract as President of Premier Finance when it expired.

Q. Do I understand that Mr. O'Neill was President of Premier Finance and he personally operated a business called O'Neill Finance and O'Neill Finance had loaned money to Racan Photocopy as had Premier Finance, and do I understand you to say that Premier Finance loaned money to Racan which was then used by Racan to pay O'Neill Finance?

A. Either on that basis or when collections came in from Racan it was applied in the first instance to O'Neill Finance. Mr. O'Neill was custodian of quite a substantial amount of Racan's shares as collateral for the Racan loan.

These shares were selling in the open market at anywhere from \$26 down and, to my knowledge, I know that at least 10,000 shares were sold into the market and taken out of these shares that Mr. O'Neill had in his custody and applied against the loan in the first instance to O'Neill Finance and in the second instance to Premier. He collected 18 per cent interest and his entire principal out of the ensuing transactions.

Q. Who was supposed to hold these shares as collateral?

A. In the initial instance Mr. O'Neill held them. They were given to him by Mr. Rabbiah and when I say he held them it is quite possible that he assigned them to Mr. E. M. Sprackman, C.A., who was the auditor for Premier Finance and who was supposed to spend a fair amount of time at Racan checking out the position.

Q. Then with respect to the loans made in 1965 by Commodore Sales to Racan do I take it they were made solely in the exercise of business judgment, which events may have shown to be faulty, but that there was no particular pressure placed upon you or any other motive in existence for the making of these loans?

A. No, they were purely and simply a calculated business risk and they were put on the books of Commodore with my express instructions to watch them like a hawk."

Racan's Corporate Records: Falsification of the 1962 Prospectus

What constituted "watching like a hawk" must be returned to again, but for the moment Mr. Orr's examination of the records of the company may intervene. Its minute books¹ contain no records beyond March 17, 1964. The directors of the company, with their dates of appointment and resignation derived from this source, were as follows:²

	<i>Date Elected</i>		<i>Date Resigned</i>	
Elias Y. Rabbiah	May	6, 1960		
Louis Herman	May	6, 1960	September	21, 1962
Hector Mansfield Howell	May	6, 1960	September	15, 1960
Riva Rabbiah	September	15, 1960	August	31, 1962
Blair T. Fergusson	August	31, 1962)	October	12, 1962
	November	26, 1963)		
W. O. Chris Miller	September	21, 1962	June	13, 1963
Earle B. Hawkins	October	12, 1962	June	13, 1963
Joseph Heindl	July	12, 1963	March	17, 1964
Henry Evering	July	12, 1963	August	26, 1963
Kenneth George Lennie	August	26, 1963		
E. Manning Sprackman	November	26, 1963		
Louis Winthrope	November	26, 1963		

¹Exhibits 267-8.

²Exhibit 4022.

As at March 17, 1964, therefore, it appears that directors and officers consisted of Rabbiah, Fergusson, Lennie, Sprackman and Winthrope, although, according to the "Survey of Industrials" for 1965, published by the *Financial Post* of Toronto, and the records of the Provincial Secretary, Heindl was still shown as a director and Nathan Bloch of Pretoria, South Africa, D. E. VanKoughnet of Washington, D.C. and Stephen C. Wengle, an associate of Samuel Ciglen, had been added to the board. A receiving order under the Bankruptcy Act was made against the company on August 6, 1965 and the Clarkson Company was appointed trustee. Racan was, at different times in its history, represented by the law firms of Herman & Moses, Blake, Cassels & Graydon, Solomon & Singer and Samuel Ciglen & Associates.³

The prospectus filed with the Ontario Securities Commission and dated October 12, 1962 has already been referred to.⁴ It contained a statement of earnings by the company from incorporation on May 6, 1960 to June 30, 1962, the latter being also the date of the accompanying consolidated balance sheet. These were both given an unqualified opinion by Price, Waterhouse & Co., as were the published statements as at June 30, 1962 which contained a statement of earnings for the nine-month period immediately preceding that date.⁵ The balance sheet contained in the prospectus was signed by E. B. Hawkins and E. Y. Rabbiah as directors. This is reproduced overleaf. It does not properly reflect the affairs of the company as later known, although accurately prepared from the company's books.

It will be noted that the only loan payable shown under current liabilities amounted to \$77,789. Under accounts receivable is shown, as "Due from a Director (since repaid)", the sum of \$21,133 and Note 1 to the balance sheet reads: "The subsidiary companies included in the consolidated balance sheet are three companies which were purchased at their net book value of \$49,210 from a director who is also the principal shareholder of the Company as of June 30, 1962. The purchase price was credited to the director's outstanding account with the Company." Paragraph 13 of the prospectus reads in part: "On June 30, 1962 all the outstanding shares of Belpree Co. Limited, Racan Office Supplies Limited and Contrading Company Limited were purchased by the Company from Mr. Rabbiah in each case for the then net book value of the assets of the company concerned which included nothing for goodwill. The aggregate purchase price for the three companies was \$49,210". Note 1 to the balance sheet includes information that the purchase price was credited to this director's outstanding account with Racan. All working papers of Price, Waterhouse & Co. in connection with this statement

³Exhibit 433.

⁴Exhibit 271.

⁵Exhibit 4023.

RACAN PHOTO-COPY CORPORATION LIMITED
and Subsidiary Companies

Consolidated Balance Sheet as at June 30, 1962

Current Assets:		Assets	
Cash			\$ 55,823
Marketable securities at cost (market value—\$5,553)			8,959
Accounts receivable—			
Trade, less allowance for doubtful accounts \$10,260	\$144,992		
Employees and sundry accounts	13,350		
Other (unconditionally guaranteed by a director)	61,399		
Due from a director (since repaid)	21,133		240,874
Inventories at the lower of cost or market—			
Paper and supplies	229,284		
Machines	93,874		
Material in Transit	33,790		
Other	46,389		403,337
Prepaid expenses			2,768
			<u>711,761</u>
Fixed Assets, at cost:			
Land	63,343		
Buildings	137,864		
Machinery and furniture	62,432		
Automotive equipment	22,300		
	<u>285,939</u>		
Less—Accumulated depreciation	27,845		
	<u>258,094</u>		
Leasehold improvements, amortized	1,362		259,456
Organization Expense			1,873
			<u>\$973,090</u>
		Liabilities	
Current Liabilities:			
Bank overdraft (secured)	\$ 10,045		
Accounts payable and accrued liabilities	122,710		
Loan payable	77,789		
Income taxes payable	89,359		
Mortgage payments due within one year	5,935		\$305,838
Mortgages Payable:			
6¾ % first mortgage maturing July 15, 1964	36,000		
6 % chattel mortgage maturing March 1, 1967	19,700		
7 % second mortgage maturing June 30, 1967	84,000		
	<u>139,700</u>		
Less—Amounts due within one year	5,935		133,765
Total Liabilities			<u>439,603</u>
Capital and Surplus:			
Capital Stock (now reconstituted)			
Authorized—			
40,000 7% non-cumulative preference shares with a par value of \$10 each, redeemable at \$11 each	\$400,000		
100,000 common shares with a par value of \$1 each	100,000		
	<u>\$500,000</u>		
Issued and fully paid			
40,000 preference shares	400,000		
10,000 common shares	10,000		
	<u>410,000</u>		
Retained earnings	123,487		533,487
			<u>\$973,090</u>

Approved on behalf of the Board:

(Signed) E. B. HAWKINS, Director

(Signed) E. Y. RABBIAH, Director.

were produced by that firm;⁶ other financial statements were found in the form of a report for the period March 15, 1960 to September 30, 1960, described as an interim balance sheet, and an interim statement of profit and loss with a report by William Eisenberg & Co., chartered accountants, saying that they had been unable to form an opinion;⁷ an unaudited balance sheet at September 30, 1961 on paper of the same firm,⁸ an unidentified balance sheet at December 31, 1962,⁹ the financial statements of the company for the period ended June 1963 accompanying the annual report as at that date, with an unqualified opinion expressed by Grammer, Birnbaum & Co., chartered accountants;¹⁰ and a balance sheet, as at December 31, 1963, obtained from E. M. Sprackman & Co., chartered accountants, containing no opinion at all.¹¹ Finally there was a consolidated balance sheet dated June 30, 1964, and a profit and loss and retained earnings statement for the year ended at that date, with notes and an auditor's report given by Grammer, Birnbaum & Co.¹² In this report the accountants said that they were unable to express an opinion on the financial statements because they were "unable to satisfy ourselves as to the company's general internal control and we were unable to obtain the information, explanations and confirmation that we required."

Complicity of O'Neill Finance Company and Premier Finance Corporation

As at June 30, 1962, the date of the Price, Waterhouse & Co. report contained in the prospectus, the amount shown as a loan payable of \$77,789.02 was derived from confirmation on the notepaper of O'Neill Finance Company headed "Statement of Account for Racan Photo Copy", sent directly to Price, Waterhouse & Co., and which invites comparison with the actual records of the O'Neill company in the custody of the Ontario Securities Commission. There were two sets of cards for Racan Photo-Copy Corporation, one being for accounts receivable and the other referred to as "Loan", also containing the words "Master Cards", the balance, without interest, of \$77,018.83 reported being shown on card No. 23.¹ However, other cards show that at April 17, 1962 there was a loan outstanding of \$190,000 on which no payments had been made, and would consequently have been considered due at June 30, 1962. On one of them is a note in handwriting, "June 19 paid \$69,033 (hold Chk-delayed)", referring to a cheque evidently not cashed when received. A further loan, totalling \$150,000 at June 30, is recorded on another card as having been advanced May 18 and due August 18, 1962.

⁶Exhibit 4024.

⁷Exhibit 4025.

⁸Exhibit 269.

⁹Exhibit 270.

¹⁰Exhibit 272.

¹¹Exhibit 4026.

¹²Exhibit 4027.

¹Exhibit 4029.

A third loan of \$75,000, made on June 15 and due September 15, 1962, was also recorded as outstanding, and these three loans, totalling \$415,000, were transferred to a master card on July 15, 1962. Three cheques signed for O'Neill Finance by "E. Ferguson", drawn on the Toronto-Dominion Bank at King and Yonge Streets, require examination. The first, dated April 17, 1962 for \$190,000 payable to Racan, was endorsed on the back in handwriting "Racan Photo-Copy Corp. Ltd.", with the signature "E. Rabbiah", and apparently deposited in the Canadian Imperial Bank of Commerce branch at Yonge Street and St. Clair Avenue.² The second, dated May 18, 1962, was drawn on the same account in the amount of \$150,000, also payable to the company and endorsed in handwriting "Racan Photo-Copy Corporation Limited", and twice thereunder "Y. Rabbiah". The third cheque was dated June 15 1962 for \$75,000, bearing a rubber stamp endorsement "for deposit only", and a further stamp reading "Racan Photo-Copy Corporation Limited." This cheque is not marked in any way with a reference to the Canadian Imperial Bank of Commerce.³ Only one note, and that in connection with the \$75,000 loan, was found; it is dated June 15, 1962, shows a due date of September 15, 1962 and is signed for Racan with the signature of Rabbiah. The rate of interest was expressed as 1/20 of 1% on the daily balance.⁴

At this time Racan Photo-Copy Corporation had at least two bank accounts, one with the Canadian Imperial Bank of Commerce, Yonge and St. Clair Branch, and another with the branch of the Toronto-Dominion Bank at Mount Pleasant and Davisville Avenues. In the case of the former, ledger cards from August 2, 1960 to August 16, 1962⁵ contain a typewritten note reading: "Caution—Refer all entries to manager or accountant. Co. has account also at Toronto-Dominion Mount Pleasant and Davisville." A deposit of \$190,000 is entered for April 17 and for \$150,000 on May 18, but the \$75,000 cheque was evidently deposited in the Toronto-Dominion account. A statement of account for Racan on the letterhead of O'Neill Finance Company,⁶ showing these advances on the same dates, was found by Mr. McGuire in Rabbiah's suitcase in the basement of Lennic's house. The two amounts of \$190,000 and \$150,000 were withdrawn in the first case on the day after deposit, and in the second, on the same day, and deposited in an account in the same branch of the Canadian Imperial Bank of Commerce, in the name of "Yassin Rabbiah".⁷

It remains to be seen how Premier Finance Corporation discharged its duty to its debtor's auditors. The working papers of Price, Water-

²Exhibit 4030.

³Exhibit 4032.

⁴Exhibit 4033.

⁵Exhibit 4034.

⁶Exhibit 4000.

⁷Exhibit 4035.

house & Co. contained a memorandum dated June 29, 1962, headed "Statement of account for Racan Photo-Copy Corporation Limited", with the words "Interest only, paper shipment only", beneath the heading, stroked out. There are eight separate calculations of interest, four for May and four for June 1962, producing a total of \$18,557.68 and a handwritten note, apparently made by a member of the accounting staff, reads "rec'd direct from Premier Finance".⁸ A second memorandum of the same date gives particulars of "paper purchases", showing sales by Premier Finance to Racan amounting to \$279,216 and payments on account of \$279,215.40. A third, also dated June 29, addressed to the attention of Mr. E. Rabbiah, advises him that the "balance of the paper shipment we are holding" amounts to \$50,124. This is an example of loans made by Premier Finance against warehouse receipts, reputedly in connection with the purchase of paper, and as far as the auditors could determine, since Racan did not record the purchase or the debt until July 3, all that was owing to Premier Finance at the year-end was the charge for interest which was duly taken into account on the earnings statement. Premier Finance used the same card system to record loans as O'Neill Finance, as one might expect, and an examination of these⁹ shows the amount of \$50,124.60 as the balance at June 22, clearly related to the unpaid balance for the paper shipment, but four other loans were recorded on separate cards as outstanding at June 6. One is for \$150,000, marked "three times \$50,000 August 6, 1962", showing a balance of \$150,000 outstanding at the end of June. A second card shows a loan of \$45,000 advanced on June 15, again outstanding on June 30. A third shows an advance of \$19,000 on June 25 and a fourth of \$75,000 on June 27. All were shown as payable after June 30, 1962; all were transferred to a master card on July 15, amounting to \$289,000 payable by Racan, to which must be added the balance outstanding for paper, giving a total of \$339,124.60. In the case of the four loans of \$150,000, \$45,000, \$19,000 and \$75,000 promissory notes were found with corresponding dates, signed for Racan by E. Y. Rabbiah and all payable to Premier Finance Corporation.¹⁰ All the cheques representing these advances were deposited in the Racan account of the Canadian Imperial Bank of Commerce, Yonge and St. Clair Branch, and corresponding withdrawals and deposits into Rabbiah's have been positively identified. Cancelled cheques of Premier Finance have not, however, been found.

Price, Waterhouse & Co. Deceived: The Duplicate Bank Confirmation

These examples of loans being made by Premier Finance to Racan Photo-Copy Corporation which are not recorded on the books of the

⁸Exhibit 4024.2.

⁹Exhibit 4039.

¹⁰Exhibit 4040.

latter, and the proceeds of which are immediately withdrawn and re-deposited in Rabbiah's personal account, are not isolated; the procedure was evidently adopted in connection with the first loan made in the amount of \$152,886.40 on December 5, 1961, a second for \$50,000 on January 11, 1962, a third on February 5 for \$75,000, a fourth on February 9 for \$160,960 and a fifth on March 1 for \$93,380. All of these were deposited and coincide with the records of Premier Finance.¹ There is cogent evidence of the fact that concealment of these loans by Premier Finance and O'Neill Finance was planned by Rabbiah, presumably not alone, from the very beginning. Price, Waterhouse & Co. were asked to prepare an unaudited statement at December 31, 1961, and carried out the usual procedure of sending out the form of bank confirmation agreed upon between the Canadian Bankers' Association and the Canadian Institute of Chartered Accountants. This is, in form, a request to its bank by a company, the accounts of which are being audited, to give specified information to its auditors. The document consists of two identical sheets one of which is marked "Original to be retained by bank", and the other "Duplicate to be sent to auditor", and the two parts are bound together, so that the duplicate can be conveniently made a carbon copy of the original. In the working papers of Price, Waterhouse & Co. a duplicate of this form was found, answering "nil" to all the questions asked, including the state of the balance in the Racan account at the Canadian Imperial Bank of Commerce.² The signature at the foot of this duplicate confirmation begins with a "B" and is otherwise illegible, but is followed by the word "Accountant" and dated January 29, 1962. This "nil" balance corresponded with the ledger in the books of Racan, and a small balance of \$7.83 was shown by the previous auditor in confirmation of the balance at September 30, 1961. Since from August 1961 the company had begun to deal with the Mount Pleasant and Davisville Branch of the Toronto-Dominion Bank, the auditors, looking at the company's books and the duplicate bank confirmation, would be led to believe that the Canadian Imperial Bank of Commerce account had been closed, and there is a note to the effect that such action had been taken during the last quarter of 1961 in their working papers. But the original of the bank confirmation was found in the bank's possession by the Securities Commission; this was typed on a different typewriter and showed a credit balance of \$10,230.20.³ It was initialled for the accountant by a different hand, although both the original and the duplicate were signed in the space provided for the client's authorization, in Rabbiah's unmistakable backward-sloping handwriting. The balance indicated on the original report coincides with that shown on

¹Exhibit 558.

²Exhibit 4024.5.

³Exhibit 4043.

the bank's ledger cards for the Racan account. Since an addressed envelope returnable to the auditor is normally enclosed when bank confirmations are sent out, for the express purpose of preventing collusion between client and bank, the duplicate in this case was evidently intercepted and changed before being mailed; one can only speculate on the way in which this was done, but a casual offer to assist, or a declaration of urgency, no doubt would have sufficed. Had Price, Waterhouse & Co. received the true copy of the original form retained by the bank, they would have noticed at once that the reported balance in the Canadian Imperial Bank of Commerce account did not agree with the books of Racan, and the concern created by this anomaly would have led to the discovery that there were deposits going in and out on the same day, like that of \$50,000 from Premier Finance on January 11, 1962. Certainly a deposit of \$152,886.40 on December 6, 1961 would have leapt at them, and their eyes would have been opened to the fact that the loans being received by Racan were not recorded on their books. Deceived as to the existence of a credit balance in the Racan account at the Canadian Imperial Bank of Commerce by the falsified bank confirmation, the auditors were prevented from becoming aware of Premier Finance as a creditor at all, and of the true position of the loans made by O'Neill Finance. The books of Racan gave the impression of a cessation of business with the Canadian Imperial Bank of Commerce at August 1961 and the assumption of a new banking arrangement with the Toronto-Dominion Bank, the records of which corresponded with it. In short, after this deception any one could take cheques payable to Racan, deposit them in the company's Canadian Imperial Bank of Commerce account and withdraw the money deposited without the auditors knowing anything about it, and the lending companies would get their cheques back showing the moneys duly deposited to the credit of the borrower.

Rabbiah as a Creditor of Racan

Enough has now been said to establish the fact that the financial statement of Racan Photo-Copy Corporation, as at June 30, 1962, was false, and that its falsification was due to deliberate action taken by the company's president, E. Y. Rabbiah, and perhaps Clarence F. O'Neill, to deceive the company's auditors and to secure their unqualified opinion as to its fairly representing the state of the company's affairs. From this deception flowed that of the Ontario Securities Commission which accepted for filing the prospectus in which these statements appeared, and deception of those members of the public who were invited to purchase the shares of Racan and trade in them on the unlisted market thereafter. The consolidated balance sheet set out in the prospectus showed total capital and surplus in the amount of \$533,473. If Racan

had reflected the additional indebtedness of \$704,000 concealed from the auditors, and if there were no countervailing entries on the assets side, there would have been a deficit, after all capital and surplus had been wiped out, of about \$166,911. In fairness to Rabbiah an inquiry must be made as to whether the facts of this situation are consistent with his claim, made subsequently before the Ontario Securities Commission, that this money was being lent to him by Racan, or was paid to him in repayment for loans made by him to the company. It has been seen that \$49,210 was recorded as having been paid to him for the sale of Belpree, Racan Office Supplies and Contrading Company, and that this amount had been credited to his outstanding account with Racan. The balance sheet of January 30, 1962, nevertheless, shows only one account receivable as due from a director, and marked "since repaid", in the amount of \$21,133 outstanding at June 30. In fact the books of Racan did not disclose anything resembling accounts receivable from Rabbiah necessary to sustain a position of genuine indebtedness to the company. There is a letter of representation addressed by him on Racan's behalf to Price, Waterhouse & Co., and dated July 25, 1962.¹ This is in the form habitually used by auditors and two passages are pertinent, the first reading "all ascertainable liabilities of the company are included as such or specifically reserved for in the accounts at June 30, 1962, and we have no knowledge of any law suits, tax claims or litigation of any consequence pending against the company nor of any other contingent liabilities of whatever nature." The last paragraph concludes, "the company has not during the period under review nor subsequent thereto entered into any contracts or agreements not in the ordinary course of business nor have any other conditions come to our attention which would materially affect the financial statements as of June 30, 1962 or the future operations of the company." These statements, signed by Rabbiah, were also false.

Three letters were found in the files of E. M. Sprackman, all dated June 30, 1963, in the form of unsigned copies, two of which are from O'Neill Finance Company and one from Premier Finance Corporation.² O'Neill Finance acknowledges in one the payment of principal in the amount of \$2,889.02 and interest of \$4,936.45, and in the other a large repayment of \$125,000. The letter from Premier Finance confirms payment by Rabbiah on behalf of Racan of \$50,124, or in other words the amount of the debt outstanding for packages of paper recorded in July of the previous year, plus \$7,500 in interest. Ultimately, after the prospectus and the certificate of Price, Waterhouse & Co. had fulfilled their purpose, loans are recorded in the books of Racan as at June 30, 1963 and appear in the financial statement included in the report to the shareholders of that date, certified by Grammer, Birnbaum & Co. The general ledger of

¹Exhibit 4024.6.

²Exhibit 4045.

Racan shows two accounts, one marked "Suspense" and the other "Research and Development." On the former there appears a handwritten journal entry in the middle of the page, containing two columns, one headed "debit" and the other "credit", the debits being to "research and development" in the amount of \$473,935.07, and another to "purchases" in the amount of \$152,342. The credits are to "E.Y.R." in the amount of \$126,277.07 and to "Loan Payable—O'Neill Finance" for \$500,000. As at June 30, 1963, therefore, Racan evidently took the position that Rabbiah had spent \$473,935.07 on research and development out of his own pocket, that he had made purchases for the company personally in the amount of \$152,342 and that it was going to pay Rabbiah by bringing on to its books, for the first time, a loan of \$500,000 from O'Neill Finance, and set up the remainder of \$126,277.07 as being owing to Rabbiah himself. The amount for research and development was duly set up as an asset, and Note 2 to the statements says it was incurred in the development of one of the companies' products and paid in foreign currency. Long-term liabilities included loans payable of \$500,000 and "advances from a director" in the amount of \$298,572, but Note 4 relating to these gave no particulars of the latter indebtedness.³ No doubt it included payments to the finance companies made by Rabbiah on the company's behalf. If the payments in respect of research and development and other purchases were actually made by Rabbiah there can be no quarrel with this accounting treatment; if not, it simply masks embezzlement of the company's funds.

S.O.P. Business Machines and Copy Distributors

A brief account must be given of the transactions which led to the prosecution of Rabbiah and Lennie, and requires further scrutiny of the company's books. The disbursements ledger of Racan, copies of which were made photostatically for the Commission from the originals entered into evidence at the preliminary hearing¹ for the period January to June 1965, contain significant entries. During this period the company's sole source of revenue of any account was Commodore Sales Acceptance which was factoring its accounts receivable on the same basis as had Trans Commercial Acceptance, at a discount of 20% and an interest charge of 12% per annum. Entry No. 8 on page D124 of the disbursements journal shows a cheque payable to "S.O.P." in the amount of \$2,080. On the following page, in connection with a similar payment on January 14, the letters "S.O.P." have been clumsily erased and the letters "COPY D" have been written over them, the original full stops showing clearly through. On this page there are three such alterations and many

³Exhibit 272.

¹Exhibit 4047.

more on other sheets, the charge being made to accounts payable. From the middle of January to the end of April 1965 when, according to A. G. Woolfrey, Commodore Sales Acceptance ceased to factor the accounts receivable of Racan, 67 cheques are recorded as having been paid to Copy D or Copy Dist., an abbreviation for Copy Distributors. Of these 19 were recovered in cancelled form from the branch of the Royal Bank of Canada at St. Clair Avenue and Alvin Street, and in each case they are payable to "S.O.P. Business Machines".² They are all dated either from the end of March or in April of 1965. In addition Mr. Orr found four cheques payable to S.O.P. Business Machines which were not cashed, and which correspond to four entries in the disbursements journal, dated April 26, drawn on the same branch of the Royal Bank and identified as having been presented and not met by the stamp: "pursuant to clearing rules this item may not clear again unless certified".³ All of these 23 cheques, payable to S.O.P. Business Machines, are signed for Racan Photo-Copy Corporation Limited by Kenneth G. Lennie, and all are endorsed on the back with the typewritten words "S.O.P. Business Machines" and the handwritten signature "D. Ortiz". They are all stamped "pay to the order of any bank or Canadian Imperial Bank of Commerce Yonge and St. Clair", and on 12 there appears the endorsement "deposit to the credit of E. Y. Rabbiah at the Canadian Imperial Bank of Commerce." For all of the 19 cheques negotiated there were seven deposit slips,⁴ all in relation to the account of E. Y. Rabbiah at the Canadian Imperial Bank of Commerce, and the total of the money deposited was \$248,200. The aggregate of the four cheques made to S.O.P. Business Machines on April 26, and not cleared by the bank, is \$53,000. Six original invoices of Speed-O-Print Business Machines (Canada) Limited totalling \$171,635,⁵ and two accounts payable ledger sheets headed, "Speed-O-Print (Canada)" and "Speed-O-Print (Canada) Limited", were found in the basement of Lennie's house at the time of his arrest, and were in consequence missing from the corporate records of Racan.

Speed-O-Print Business Machines Inc. was a company in Chicago with which Racan did a substantial amount of business, and Speed-O-Print Business Machines (Canada) Limited was its Canadian subsidiary company. Burton Tilden, vice-president of the Chicago firm, and Mrs. Matilda Cattoir, export manager, both of whom testified at the preliminary hearing against Rabbiah and Lennie,⁶ denied that the invoices in question were those of their Canadian company, and said that in 1964 and 1965 it sold only \$810.75 worth of goods to Racan. Siegfried

²Exhibit 4016.

³Exhibit 4048.

⁴Exhibit 4049.

⁵Exhibit 4007.

⁶Exhibit 3998.

Fischer, doing business in a basement shop under the name of Fibo Printing, swore that he had printed 100 invoices for Racan from a plate which had been delivered to him, and positively identified, from imperfections in the plate, the invoices found in Lennie's basement as produced by his shop. He did other work for Rabbiah, printing forms for S.I.M. Equipment, Queensland Acceptance Company Limited and Mutual Bank & Trust Company Limited in the Bahamas.

Daniel Manuel Ortiz, from September 1960 to September 1963 export manager of Speed-O-Print Business Machines in Chicago, is an American citizen now engaged in business with his father in Cuernavaca, Mexico, and he was interviewed by Mr. McGuire on May 24, 1966 in Mexico City.⁷ Subsequently Ortiz made an affidavit in the Spanish language, signed "D. M. Ortiz", and sworn before a notary public. A translation of part of this reads as follows:⁸

"I joined Speed-O-Print Business Machines Corporation in Chicago, Illinois as Export Manager around August or September 1960. My duties were to promote sales and distribution outlets for Speed-O-Print products in all areas outside the continental United States. I remained in that position until about September 1963 when I resigned in order to join my father in business in Cuernavaca where I have lived and worked ever since.

I met Elias Rabbiah through Burton Tilden, sales manager and vice-president of Speed-O-Print. Rabbiah had approached Speed-O-Print as a stranger with an offer to buy initially about one hundred Model 'B' diffusion transfer copiers on a cash basis. A deal was made and a shipment sent shortly thereafter. We had been looking for a distributor for the Canadian market and Rabbiah seemed a good choice. From this initial sale the relationship between Speed-O-Print and Rabbiah and/or Racan Photo-Copy Corporation Limited developed into a regular business in machines, paper and chemicals.

In connection with the business done with Racan, I dealt with Elias Rabbiah and Joseph Heindl. As time went on, Heindl appeared to lose some of his authority.

During the period of my employment with Speed-O-Print I was never authorized to sign or endorse cheques for that company and in fact, I never did so.

I have examined and initialled nineteen original cheques on the form of The Royal Bank of Canada, St. Clair and Alvin Branch, Toronto, Ontario, drawn on Racan Photo-Copy Corporation Limited and made payable to S.O.P. Business Machines. The nineteen cheques are numbered and dated for the amounts as follows:

No. 950.....	March 30th, 1965.....	\$ 3,500.00
No. 951.....	March 30th, 1965.....	\$ 4,100.00
No. 954.....	March 30th, 1965.....	\$ 4,500.00

⁷Exhibit 4017.

⁸Exhibit 4018.

RACAN

No. 960.....	March 30th, 1965.....	\$ 3,300.00
No. 972.....	March 31st, 1965.....	\$ 3,785.00
No. 973.....	March 31st, 1965.....	\$ 2,400.00
No. 974.....	March 31st, 1965.....	\$ 1,815.00
No. 975.....	March 31st, 1965.....	\$ 4,300.00
No. 978.....	March 24th, 1965.....	\$ 3,700.00
No. 1039.....	April 7th, 1965.....	\$17,000.00
No. 1040.....	April 7th, 1965.....	\$15,000.00
No. 1041.....	April 7th, 1965.....	\$11,000.00
No. 1063.....	April 12th, 1965.....	\$46,500.00
No. 1117.....	April 15th, 1965.....	\$22,000.00
No. 1118.....	April 15th, 1965.....	\$24,000.00
No. 1119.....	April 17th, 1965.....	\$22,300.00
No. 1143.....	April 20th, 1965.....	\$22,000.00
No. 1144.....	April 20th, 1965.....	\$19,700.00
No. 1145.....	April 20th, 1965.....	\$17,300.00

The reverse side of each of these cheques bears the printed endorsements 'S.O.P. Business Machines' and the written endorsement 'D. Ortiz'. I have never seen these cheques before and the written endorsement in each case is not my signature. I did not sign any of these cheques.

The glossy 8" by 10" print shown me is a picture of Elias Rabbiah and I have initialled it on the reverse side.

I have been shown a photo-copy of a 1959 M-A Invoice dated at Chicago November 30th, 1961 No. 03654 covering 429 packages of paper for a total of \$152,886.40. The written name on this form 'D. M. Ortiz' is not my signature. The amount of this order is far greater than normal.

I have been shown photo-copies of a 1959 M-A Invoice dated at Chicago May 30th, 1962 No. 26946 covering 560 packages of paper for a total sum of \$279,160.00 and a 1959 M-A Invoice dated at Chicago June 14th, 1962 No. 27348 covering 598 packages of paper for a total sum of \$346,440.00. These were never billed by Speed-O-Print and the sums are far in excess of the average Racan purchase.

I have been shown original 1959 M-A Invoices as follows:

#02574.....	September 15th, 1961	\$39,003.10
#12275.....	December 11th, 1961	\$46,789.50
#SP-1492A.....	December 28th, 1961	\$23,359.62
#18791.....	January 9th, 1962	\$49,083.15
#26040.....	March 6th, 1962	\$45,473.35

I have no particular recollection of any of these invoices but they do appear to be normal for business with Racan. The signature on each invoice 'D. M. Ortiz' is not mine but could be the writing of my secretary, Mrs. Matilda Cattoir. Mrs. Cattoir was authorized to sign for me in such circumstances. The source of the paper at or near Newton, N.J.

was Anken Chemical Company. Maislin Bros. Transport Limited of Newton, New Jersey was instructed by Speed-O-Print in each instance to pick up the paper at Anken and deliver it to Racan in Toronto.

At the time Racan went public, Elias Rabbiah told me he had reserved in the neighbourhood of 2,500 shares of Racan for me. I think the price was \$2.00 per share. Shortly afterward, Mr. Abe Samuels advised all at Speed-O-Print who had purchased shares of Racan to get rid of the Racan shares immediately. The shares I bought were registered as joint ownership with my wife. I sold them at once, but I do not recall the price.

Since leaving the employ of Speed-O-Print, I have not seen or spoken to Rabbiah or anyone connected with Racan Photo-Copy Corporation Ltd."

McGuire also inquired as to what was known about Copy Distributors, a blank letterhead of which, giving the address 8350 Drummond Avenue, Montreal, Quebec, was found in Rabbiah's suitcase in Lennie's basement, together with a series of copies of deposit slips for Rabbiah's bank account referring to cheques with the name "Copy Dist." marked on them. No such street as Drummond Avenue exists in Montreal, nor any such number on the well-known thoroughfare called Drummond Street. The 67 cheques shown on the disbursements journal as having been issued to Copy Distributors amount in the aggregate to \$490,921 in 1965. The records of Racan compared with the records of the Rabbiah account at the Canadian Imperial Bank of Commerce, Yonge and St. Clair Branch,⁹ indicate that Rabbiah paid back to Racan \$303,659 of this amount, leaving \$187,262 to be accounted for.

A brief note on the nature of the evidence, as supplied by comparison of the ledger cards of the Rabbiah account covering the period August 31, 1964 to May 31, 1965 and those of the Racan account at the Royal Bank of Canada, St. Clair and Alvin Branch,¹⁰ may suffice, since it applies to all of the 19 cancelled cheques recovered. Cheque No. 1063, dated April 12, 1965, is recorded in the disbursements journal as the first item on page D140. The cheque is made out to S.O.P. Business Machines and the number of the cheque corresponds with the number shown on the disbursements journal, but the name of the payee on the latter has been written over "S.O.P." as "COPY DISTR". The cheque has the usual typewritten endorsement "S.O.P. Business Machines" and the handwritten signature "D. Ortiz"—and here it may be said that there has been an obvious attempt made to reproduce the handwriting of Ortiz—and below that appears the endorsement to deposit to the credit of "Mr. E. Y. Rabbiah—Canadian Imperial Bank of Commerce." The Royal Bank ledger card for Racan shows a withdrawal on April 12 in

⁹Exhibit 4050.

¹⁰Exhibit 4051.

the amount of \$46,500, and there is a corresponding deposit slip¹¹ for the same date showing a total deposit in the sum of \$137,500 of which \$46,500 is one item, indicating a deposit in the Canadian Imperial Bank of Commerce account matched by an entry on the bank's ledger card for Yassin Rabbiah. Rabbiah's explanation, such as it is, was given in his examination for discovery in the bankruptcy of Racan Photo-Copy Corporation Limited, taken on December 22, 1965.¹²

“Q. Mr. Rabbiah, the books of original entry indicate that the cheques were issued to S.O.P. Business Machines and subsequently a notation, S.O.P. was changed to Copy Distributors. This was done in respect of every cheque issued, almost every cheque issued to S.O.P. Business Machines. Can you tell me why this was done?

A. I can't tell you anything.

Q. Who are Copy Distributors?

A. Copy Distributors are suppliers of paper.

Q. Where do they carry on business?

A. They carried as far as I know in Montreal and Toronto and a place in Chicago, but more than that I don't know.

Q. Who did you deal with?

A. I never dealt with them, I only guaranteed their account.

Q. Who did you deal with when you guaranteed their account?

A. Mr. Gardiner.

Q. What is his full name?

A. I believe he is called Allan, I think Allan Gardiner.

Q. Where did you meet him?

A. I met him through Mr. Lennie.

Q. What is his address?

A. I have no idea—in Montreal.

Q. Did you make payments to Copy Distributors?

A. Yes, I did make some payments.

Q. How did you make these payments?

A. Some of them by cash, some of them by cheque.

Q. Why did you make the payments?

A. Because I guaranteed the account and Racan didn't pay it.

Q. Racan paid S.O.P. Business Machines, why couldn't it have paid Copy Distributors directly?

A. They wouldn't take any Racan cheques.

¹¹Exhibit 4049.

¹²Exhibit 3685.

Q. Even certified cheques?

A. Mr. Baird, Racan could never have certified a cheque.

Q. Why?

A. Because they simply didn't have the money to certify the cheque with, so they could only depend that somebody else should pay and then later on the amounts would be split up in small amounts, you see.

Q. We have attempted to locate Copy Distributors at 8350 Drummond Avenue, Montreal, Quebec, and we have been advised that they are unknown at that location. Can you tell me where they are at present time?

A. I can't tell you, no. Probably Mr. Lennie would know, maybe he is in contact with them.

Q. What dealings did you have with Copy Distributors?

A. That is the only time that I—

Q. Have you a copy of the guarantee you signed?

A. The only one.

Q. Have you a copy of the guarantee?

A. No, they had my word that I guaranteed the account.

Q. Did you sign a guarantee?

A. No, I never signed any guarantee. All the people, you see, that I guarantee it is strictly on a word basis.

Q. You didn't sign any of these guarantees?

A. No."

Rabbiah's Expenditures on Research and Development

A more substantial item in the subterranean dealings of Elias Rabbiah with his own company is the asset, previously referred to, shown as research and development in the company's report at January 30, 1963¹ recorded as \$473,935, and in the unaudited statement for December 31, 1963 as \$1,237,077.57.² It will be recalled that no such asset appears in the interim statement of December 31, 1962,³ and that, in the statement as at June 30, 1963 by Grammer, Birnbaum & Co., the pertinent note refers to expenditures made in a foreign currency. No one ever found any invoices or cancelled cheques supporting these expenditures. In working papers, acknowledged to be his by the accountant Grammer at the preliminary hearing, and headed "Racan Photo-Copy Corporation Limited—Research and Development",⁴ appear, among otherwise illegible words, the date June 30, 1963 and the phrase "as provided by E. Y.

¹Exhibit 272.

²Exhibit 4026.

³Exhibit 270.

⁴Exhibit 4052.

Rabbiah", and a number of payments are listed, together with exchange rate conversions and calculations of interest. This purports to be a list of invoices, beginning in 1961 and running through to June 1963, showing a total expended for research and development of \$473,935.07 including interest. At the foot is a note saying, "in May of each year Haenisch gets \$10,000", and the page is signed "E. Y. Rabbiah". The working papers of E. M. Sprackman contain four sheets headed, cautiously enough, by the words: "The items listed below are the amounts shown on photocopies of what are purported to be invoices for work done on the 1015 copier and are directed to E. Y. R. at 500 Avenue Road, he claims he paid these on behalf of the company." There follows a list of "payments claimed by E. Y. Rabbiah for research and development".⁵ Sprackman was auditor for Premier Finance Corporation and, at the time when these papers were completed, was also a director of Racan. The detail shows a list of payments commencing May 1, 1961 and continuing until November 1, 1963, some shown in United States dollars and some in German marks. Certain items are described as payments "to Haenisch" totalling D.M. 1,050,000. On another page headed, "The invoices read as follows—and there are one of each type each month", are handwritten copies of invoices in German with amounts of money in dollars. Another page which refers to an "original agreement dated January 4, 1962", under the injunction "examine supporting vouchers and contracts covering undertaking", lists items totalling D.M. 1,300,000, including two of D.M. 300,000 on February 11 and May 19, 1963 which appear to coincide with payments previously said to have been made to Haenisch.

A copy of an original agreement in the German language, found in Sprackman's working papers with an English translation, between Dr. Karl Heinz Haenisch and Elias Yassim (*sic*) Rabbiah⁶ provides that Haenisch grants to Rabbiah a licence to manufacture and sell throughout the world the former's invention of a photo-reproduction process for which patents have been sought. The stipulated minimum payment is \$10,000 a year plus 5% of the factory cost of each machine made. Another agreement, dated June 26, 1963, embodies an assignment of these rights by Rabbiah to Racan Photo-Copy Corporation.⁷ Sprackman's working papers indicate that the amount alleged to have been paid to Haenisch, for which Rabbiah received credit, was D.M. 750,000 up to August 30, 1963. The Commission was furnished by the Attorney-General for Ontario with an affidavit in German, to which a translation is also annexed, dated November 2, 1965, made by "Carl-Heinz Haenisch", described as a "chemical engineer of Neu-Isenburg." This was supplied

⁵Exhibit 4053.

⁶Exhibits 4065 and 4054.

⁷Exhibit 4055.

in the first instance to the Attorney-General by the *Toronto Daily Star*, and was secured by this newspaper's London representative, Mr. Robertson Cochrane. The English version is as follows:⁸

"TRANSACTION"

in Neu-Isenburg on the 2nd November, 1965

Before me the undersigned Notary

Karl Staub

within the jurisdiction of the Supreme Court (Oberlandesgericht) in Frankfurt on the Main, with Offices in Neu-Isenburg

appeared

Carl-Heinz Haenisch, Chemical Engineer of Neu-Isenburg, Frankfurter Strasse 58.

The person appearing proved his identity to the satisfaction of the Notary by the production of a driver's licence with photograph issued by the President of Police in Frankfurt on the Main on the 14.7.1937. The person appearing declared, requesting that it be authenticated, the following

ASSURANCE UNDER OATH

I, Carl-Heinz Haenisch, having been informed of the criminal consequences of a false assurance under oath, declare the following under oath:

On the 2nd January, 1962, through the intervention of my nephew Walter Kuettner in Toronto I entered into a Licence Agreement with

Mr. Elias Yassim Rabbiah,
of Toronto, Canada.

for the utilization of a chemical process which I had developed in connection with a copy machine. According to this contract I was to receive an annual amount of \$10,000.00 in return for my release of all rights to the process which I had developed, in the event of its utilization.

On this contract I have received no payments whatsoever from Mr. Rabbiah. Once I received the sum of only 5,000 German Marks from my nephew Walter Kuettner.

I have never had direct contact with the firm Racan-Photo-Company Ltd., and never corresponded or entered into any agreement with it. From this firm I have never received any payments. It is also unknown to me whether the firm Racan-Photo-Company Ltd. utilized or obtained patents on the process which I developed.

The document was read to the one appearing, confirmed by him and personally signed by him as follows:

(signed) Carl-Heinz Haenisch
(signed) Staub, Notary"

⁸Exhibit 4056.

Walter Kuettner was employed by Rabbiah as general manager of Belpree Co., and testified to the Ontario Securities Commission that Rabbiah's approach to his uncle was made through Joseph Heindl, for long a vice-president of Racan, without his knowledge.⁹

The total amount set up for research and development as an asset at June 30, 1964, at a cost of \$1,374,239.11, was paid out indirectly by Racan to Rabbiah, beginning with the entry already described, when the loan of \$500,000 from O'Neill Finance was taken on to the books and Rabbiah credited with a portion of it. A second entry, in the form of a journal entry, debits research and development and credits E. Y. Rabbiah with \$746,050. There were two others, one for \$134,000 and the other of no more than \$17,000, taken over from Belpree, the latter not being credited to Rabbiah because it was an asset of that company when it was acquired from him. By June 30, 1964 nothing of this amount is shown as being owed to Rabbiah, and he should be heard again in his own words on the subject of how this huge debt was incurred and paid. He was questioned on the subject by Mr. Baird, in the examination for discovery already referred to, as follows:¹⁰

"Q. Mr. Rabbiah, Racan from the period of its incorporation on incurred considerable expenses which are under the heading Research and Development expenses. What were they?

A. They were in connection with the various research on various products of the company, one of them is a machine.

Q. What products are you referring to?

A. Mainly I would say the 1015.

Q. What do you mean by the 1015?

A. That is a machine, a photocopy machine which we tried to develop.

Q. How were these expenses incurred?

A. I did not go through the details. I am sure we could provide you with the details.

Q. I would like to know the exact detail of every research development expense.

A. It is on the books of the company I'm sure.

Q. The books of the company do not have this.

A. I have no record of it right now because it belongs to the company, it is a record of the company.

Q. There is no record of the company making any payments on research and development, all the payments appear to have been made to you.

A. Through me maybe.

⁹Exhibit 3767.

¹⁰Exhibit 3685.

Q. The company made payments to you, Mr. Rabbiah.

A. Yes, because first of all the money was spent through me.

Q. What money did you spend?

A. I would say about one million nine hundred thousand dollars.

Q. Where did you spend it?

A. Mostly in Europe, the States.

Q. To whom did you pay the money?

A. Various people who did the work.

Q. I would like to know the details of every payment you made on research and development?

A. I shall provide you what I have but I doubt if I have any of the records, because you should have that together with all the information.

Q. There are no invoices or vouchers in the possession of the Trustee covering this?

A. Not in my possession certainly.

Q. You made all the payments, Mr. Rabbiah. What about the invoices? They would have been sent to you?

A. No, the company would have those, there was a special file in the company for that.

Q. To whom did you make these payments?

A. Various people, I don't remember to whom exactly.

Q. How did you make the payments?

A. Originally you mean?

Q. Yes.

A. You see, originally the research and development—the machine did not belong to the company, I want that clarified.

Q. To whom did it belong?

A. It belonged to me and I spent my own personal money on it. It is only at the later stage, and I can't remember the date, that the research and development was for the company.

Q. Mr. Rabbiah, the books of account indicate there is an expense for research and development of \$1,374,239.11. It appears that the company did not issue any cheques directly to any outside person for research and development expense, but rather the expenses were all incurred by you personally. Is that correct?

A. That is correct.

Q. To whom did you make the payments?

A. Various research companies, I don't have the records, you should have them.

Q. There are no records in our possession dealing with the research.

A. It is not in my possession either, I have been out of this company for a year and a half, it is up to you to find it. You went in the company, you should have all the records of the company.

Q. Mr. Rabbiah, these were expenses which you made personally, there is no reason why the company would have the records of these expenses?

A. Of course the company would have the records.

Q. Why?

A. Because the machine belongs to the company.

Q. Did you turn over every voucher and every cheque that you received in payment of the research and development expenses to the company?

A. Everything was in a separate file in the filing cabinet and as far as I can remember everything was there at the time I left, that was in March of 1964.

Q. To whom did you turn it over?

A. To no one, it was there in the file, in the filing cabinet.

Q. Did you turn over your cancelled cheques to the company as well?

A. Every record which belongs to this part of the business and to any other part of the business was right there as far as—

Q. Did you turn over your own personal cancelled cheques?

A. If it was paid by cheque I would say it would be in the records, yes; it could be in the same file.

Q. What happened to this file?

A. Don't ask me, I am asking you what has happened to it. I certainly didn't take it.

Q. Who has seen this file to your knowledge?

A. I don't know. . . .

Q. Did you make any payments to Carl Haenisch?

A. You mean to him personally?

Q. Yes.

A. You mean expenses or to him personally?

Q. Any payment to him for any reason at all?

A. He didn't gain anything personally out of it so far as I know.

MR. CIGLEN: That isn't the question, Mr. Rabbiah. Listen to what he said then try and answer. He asked you if you made any payments to Mr. Haenisch in any manner whatsoever related to this development.

THE DEPONENT: Some payments.

BY MR. BAIRD:

Q. How much did you pay him?

A. I don't know. Some amounts went to Mr. Haenisch or to whoever did the work, and he told us who made the work.

Q. Who did the work?

A. There were many people involved, I can't remember that.

Q. You don't remember anyone's name? Can you give me one name of a person who did development expense?

A. I can't give you any because the records I don't have. I wish I had copies of the records so I could give it to you.

Q. You can't tell me one name?

A. I can probably find out.

Q. You can't tell me at the present time?

A. I can find out for you as much as I can and give you all the information you want.

Q. Can you tell me one name at the present time who did research and development expense for you?

A. I think maybe there was Bosch.

MR. GRAMMER: Bosch is one of the names I remember.

BY MR. BAIRD:

Q. Who is Robert Bosch?

MR. GRAMMER: They are a large electronics firm.

THE DEPONENT: I am not sure, I can inquire for you.

MR. GRAMMER: They make a lot of electronics parts.

MR. BAIRD: Is it Robert?

MR. GRAMMER: Yes.

BY MR. BAIRD:

Q. Where do they carry on business?

A. All over the world, they are a gigantic company.

Q. With which office did you deal, Mr. Rabbiah?

A. I don't know which office was dealt, you see. As I say—

MR. CIGLEN: What country was it in?

THE DEPONENT: It was either the German or the French branch but, as I say, I can inquire.

BY MR. BAIRD:

Q. What work did they do for you?

A. I think they worked on certain electronic parts of the machine, I don't know specifically which ones.

Q. In which machine?

A. The same machine we are talking about which is the 1015.

Q. Is this the only machine that you did research and development work in respect to?

A. Yes.

Q. From whom would you inquire to find out the information that I have requested? You said you could find out with whom you did—

A. The only thing I can do is write. Perhaps they can remember some of the names.

Q. Who will you write to?

A. I would say Haenisch.

Q. You will write to Mr. Haenisch—is he the only one you can write to?

A. I will write to him, I will write to several people.

Q. Who else would you write to?

A. The thing is there were several people involved, I would have to look up their addresses and find out where they are now.

Q. What are their names?

A. Pardon?

Q. What are their names?

A. Some were working in the company at the time, one is our office in New York which used to be there, I will have to inquire from them.

Q. What do you mean your office in New York, whose office in New York?

A. Racan's office in New York.

Q. Racan had an office in New York?

A. That's correct.

Q. Who was employed in that office?

A. Pace.

Q. What is his full name?

A. John Pace.

Q. What did he do?

A. He was the manager, the man in charge.

Q. Who else would you write to, please?

A. I would write to him but I have got to find his address. I haven't been in contact with him now for a couple of years.

Q. Is there anyone else you could write to?

A. I would say that was the only two people that could give the information.

Q. Why would they know how the research and development expenses were incurred?

A. They handled the agreements with various people to do the work, you see.

Q. Where are these agreements at the present time?

A. I am saying the agreements were not in writing—not meaning agreements, they were in charge of this particular work which was done. You see, this thing has started since 1961, that is what I want to make clear to you, it isn't that the company started, I started."

The examination, which, as has been seen, took place on December 22, 1965, was resumed on January 21, 1966 and Rabbiah had an opportunity of fulfilling his undertaking to obtain information:¹¹

"Q. In our previous examination, Mr. Rabbiah, I asked you to obtain details as to whom, as to persons you had paid money for research and development. Have you obtained that information?

A. No, because I couldn't possibly obtain it. All the records, as I explained to you, have been in one single file at Racan and without that file I can't possibly know where to start."

Rabbiah's Receipts Summarized

Only a few of Rabbiah's cancelled cheques were found and these in the suitcase in Lennie's basement.¹ Twelve of them are examples of cheques paid out of his account at the Canadian Imperial Bank of Commerce, were selected because they dispose of funds originating with Commodore Sales Acceptance and may not relate to the affairs of Racan. The first is dated April 15, 1965, made payable to the bank itself to purchase a draft for \$5,000 in U.S. funds, the amount of the cheque being \$5,400. The endorsement shows that the draft was made payable to Mutual Bank & Trust Company Limited, the Bahamian company which Rabbiah admitted owning and which was incorporated for him by Sir Stafford Sands.² Four cheques, one dated April 2, two dated April 6, and one dated April 7 for \$5,000 each, and one on April 8 for \$6,000, were drawn in favour of Bache & Company, a firm of stockbrokers with which Rabbiah dealt,³ amounting in all to \$26,000. A cheque dated April 5, drawn by Rabbiah in favour of himself in the amount of \$20,000,⁴ was endorsed by him; since there is no indication of any deposit and it was evidently cashed, this substantial sum must have been withdrawn in cash. Another cheque, dated April 7, was made payable to Chemical Bank New York Trust Company for \$2,959.72;⁵ there is no

¹¹Exhibit 3686.

¹Exhibit 4003.

²Exhibits 4003.2 and 3685.

³Exhibit 4003.3.

⁴Exhibit 4003.4.

⁵Exhibit 4003.5.

evidence that Racan ever had an account there. Another in the amount of \$5,412.54 was drawn in favour of "Mutual Bank & Trust" and marked "U.S. draft." One dated April 2 was made payable to K. G. Lennie in the amount of \$10,007.50,⁶ endorsed by Lennie and presumably cashed since it was not deposited. The last cheque of the group examined was dated April 9, drawn by Rabbiah in favour of himself in the amount of \$22,000, endorsed by both Rabbiah and Lennie and also evidently cashed.⁷ Confirmations from Swiss Banking Corporation in London, also found in the suitcase, show that this institution met cheques amounting to \$20,001 issued by Rabbiah, and that on his instructions it had transferred to Union Bank of Switzerland (Account No. 410-78560U) \$4,000 in American funds.

One other payment on a large scale is indicated on page 46 of the general journal of Racan for 1964⁸ in which there is an entry, dated December 31 in that year, debiting accounts payable to Copy Distributors and crediting "advances—Y. Rabbiah" with the amount of \$250,-649, "to record pmts. made by Y.R. personally for Racan per list." No list to which this entry might refer has been found, but it amounts to a statement that the company had owed Copy Distributors this sum in connection with various transactions and Rabbiah had paid it. The amount shown as a liability on the financial statement as at June 30, 1963 of \$298,572, "due to a shareholder", had disappeared at June 30, 1964 and, however made up, must be considered as repaid.

In concluding the examination of the meagre but significant evidence of Rabbiah's transactions with Racan Photo-Copy Corporation a summary should be attempted. The amount of \$473,935.07, recorded as incurred for research and development at June 30, 1963, was presumably paid to him, although the accountant's working papers indicate that there are no slips or vouchers in verification. Of the 67 cheques recorded as paid to Copy Distributors, but written as payable to S.O.P. Business Machines, if the 19 cheques totalling \$197,000 traced to Rabbiah's personal account, and the only ones found, are to be considered examples, the total amounted to \$490,921. For March and April, 1965 five cheques drawn on Rabbiah's account have been discovered, each payable to Racan Photo-Copy Corporation for a total amount of \$303,659.⁹ There remains the difference of \$187,262 to be accounted for, and of this amount some \$106,000 has been identified in the twelve cheques drawn in April in favour of Bache & Co., Mutual Bank & Trust Company, Lennie and Rabbiah himself. The journal entry set up in connection with additional research and development, crediting Rabbiah's account with \$746,050, is also unexplained and unsupported by in-

⁶Exhibit 4003.7.

⁷Exhibit 4003.8.

⁸Exhibit 4064.

⁹Exhibit 4003.9.

voices, except as indirectly referred to in accountants' working papers. There is, further, the sum of \$250,649, said to have been paid or credited to Rabbiah to reimburse him for payments made to Copy Distributors. There is no evidence of the existence of such a concern, or of that of the man supposed to be its representative and referred to as Alan Gardiner, whom only Rabbiah and Lennie testified to having seen, and who gave as his telephone number one that turned out to belong to a chartered accountant in Toronto by the name of Morton W. Rashkis. Rashkis testified at a hearing before the Ontario Securities Commission¹⁰ that Rabbiah asked him if he could use this number for certain transactions in connection with the purchase of paper, which he did not want to "put through Racan", in 1965. The conclusion that Copy Distributors and Alan Gardiner were both fictitious is too strong to be resisted.

One amount, recorded as a charge against Rabbiah in the books of Racan, of \$691,000 is in a separate category. It is identified as a payment made to Rabbiah personally by the government of Canada for shipments of paper made to it by the company. This huge sale of copy paper was carefully investigated and must also be regarded as a fictitious transaction. It served to reduce the outstanding balance in Rabbiah's favour, so that his net receipts, all attributed to research and development, were \$683,239, for which only a few invoices involving small amounts have been found, and of which at least \$600,000 must be considered unexplained. The total amount of money passing through Rabbiah's hands at one time or another of which no satisfactory explanation can be given may be conservatively estimated at about \$1,000,000, for which there are no cheques, invoices or identification of people who received money alleged to have been paid by him for the benefit of Racan.

Clues to Identity of the "1015" Machine

From the beginning of his attempts to promote the Racan 1015 dry-copying machine Rabbiah had been secretive about the principle upon which it operated and the mechanism itself. The cover of the prototype was never allowed off and was, as a rule, sealed shut on any occasion when it was on display. His reason for this was that patents were pending, and in the highly competitive atmosphere prevailing at the time such a reason was valid enough. There was a more compelling reason for this secrecy, and it may be stated briefly by saying that, according to all the evidence, Racan Photo-Copy Corporation never produced a dry-copy machine of its own design or manufacture. The evidence of Simon Bowler, one of its salesmen, given to the Ontario Securities Commission on March 7, 1966 indicates that the machine shown in New York was a "Savin Sahara", with the name removed and the Racan emblem substituted, and that this machine had been part of the inventory of Racan

¹⁰Exhibit 3785.

for purposes of distribution for some time.¹ During the brief period of management of the company by Commodore Business Machines in which he was particularly concerned, Manfred Kapp sought consistently and without success to examine the 1015 machine. The management contract entered into on March 26, 1964 was, by the end of June, effectively at an end, and Lennie, who had been dismissed from active employment by Kapp, had been appointed president of Racan in succession to Rabbiah who, nevertheless, remained a director. Commodore Business Machines, in addition to being entitled under the agreement to \$30,000 per annum, had an option on Rabbiah's stock in the company sufficient to give it control. The worth of this option was never tested, but may be illustrated by the fact that in April 1964, in the early days of the Commodore Business Machines regime, shareholders of Racan were advised that the president and principal shareholder of the company, Elias Y. Rabbiah, had exchanged his shares for notes of Anglo-Overseas Capital Corporation Limited and advised his fellow-shareholders to do the same. Anglo-Overseas Capital Corporation was another Bahamian company, almost certainly controlled by Rabbiah, who said at different times that it was owned equally by himself and David Rush, or that he owned all the shares himself. It was introduced to the public by way of note No. 8 to the consolidated financial statements for the year ended June 30, 1964² on which, it will be recalled, Grammer, Birnbaum & Co. were unable to express an opinion. The note reads as follows:

"On November 26, 1963, the company's shareholders unanimously approved the acceptance of an offer, to the company, by Copy Research Holdings Limited, dated November 1, 1963, pursuant to which, the company agreed to sell substantially the whole of its assets, including the world rights to the dry photo-copy process incorporated in the Racan 1015 copier, for a cash consideration of \$15,500,000. (U.S. Funds). By an agreement, dated April 10, 1964, Copy Research Holdings Limited agreed to assign all of its rights in the said agreement to Anglo-Overseas Capital Corporation Limited. As at this date, the agreement which had been assigned to Anglo-Overseas Capital Corporation Limited has not been completed."

Copy Research Holdings Limited was a private company incorporated in England and was controlled by an old friend of Rabbiah's called Nathan Bloch; one of the terms of the agreement was that Racan should invest \$30,000 in its shares, which seems a very modest requirement for a company prepared to invest \$15,500,000 in purchasing Racan. It may be assumed that \$30,000 in real money was the price required by Mr. Bloch for obligating his company to pay fictitious millions at a time when Rabbiah was having some success in reviving interest in

¹Exhibit 3738.

²Exhibit 4027.

Racan stock. For this purpose it was necessary to revitalize the 1015 dry-copier, so seriously discredited in New York and Toronto in mid-1963. Manfred Kapp did not believe in the existence of the 1015 and told C. P. Morgan of his opinion. Nevertheless Morgan was convinced that the machine existed and would be brought into production; as Kapp said, Rabbiah was "quite a salesman". Eventually Kapp and the other directors of Commodore Business Machines saw what was supposed to be the Racan 1015 at Morgan's invitation, and Kapp described the occasion when he testified before the Commission on December 8, 1966.³

Q. Then there was a subsequent occasion to which you alluded briefly a few moments ago, in which you did see a machine?

A. Yes, there was an instance, as you reminded me, in 1965, I believe it was around April, early 1965, when at a meeting of the board of directors of Commodore Mr. Morgan told us that Racan finally had their machine, and that they were—would like to show it to the directors of Commodore.

Q. What did you understand this machine was supposed to be capable of doing?

A. To make copies on any sort of paper, without any liquids—basically an electro-static machine.

Q. It was a dry copy machine which would reproduce the articles sought to be copied, on any kind of paper?

A. Any kind of—

Q. Not just on sensitized paper?

A. On any kind of paper.

Q. Well, after this directors' meeting, what was the result of that discussion?

A. It was after the meeting or the following day (which I don't quite recall) we went to the office of Mr. Rabbiah and he showed us the machine. I believe that most of the Commodore directors were present.

Q. Where was the office, Mr. Kapp?

A. I think on Richmond Street West. I don't remember the address. I think it is in—

Q. Whose office was it? Was it Mr. Rabbiah's office or the Racan Photo-Copy office?

A. It was at 121 Richmond West. It was Mr. Rabbiah's office, and it was right next door to Mr. Ciglen's office.

Q. Was there a machine there?

A. There was a machine there.

³Evidence Volume 88, pp. 12058-62.

Q. Now, what happened at this attendance?

A. At this attempt copies—

Q. At this meeting?

A. There were, as I mentioned before, most of the directors of Com-modore were present, and Mr. Rabbiah gave us a demonstration of the machine.

Q. Yes?

A. Making copies of different items, sheets of paper; but it did not appear to me that it was on plain paper, the copies. Mr. Tramiel did ask Mr. Rabbiah to make a copy on a piece of paper that he picked up. Mr. Rabbiah had told him that he could not do that, because the machine was all set up and it was all taped and he couldn't open it because of patents. He was afraid if we look into it, we might see something.

Q. When you say the machine was taped, do you mean literally?

A. When I say taped, it was covered and taped, and there was some Scotch tape, and tape holding up anything that could be opened in the machine.

THE COMMISSIONER: It was sealed?

A. It was sealed.

MR. SHEPHERD: In what fashion did this demonstration consist?

A. The demonstration consisted of taking up sheets of paper on the table and putting it through the machine, in the machine, to make the copies.

Q. Yes?

A. On what appeared to be plain paper without fluid, but I wasn't so sure it was.

Q. What led you to think it was perhaps sensitized paper?

A. Because there is a certain feel and smell to the sensitized paper. I didn't notice it at the time, but I took some samples with me and I noticed on the way out.

Q. Did you come to the conclusion that the paper on which the copies had been reproduced in your presence was a sensitized paper?

A. I did not come to a conclusion, I was prepared to accept Mr. Rabbiah's word, and thinking maybe I was making a mistake. It is sometimes very difficult to tell on the paper itself.

Q. Did you make any observation about the disquiet you felt to Mr. Morgan?

A. On the way out I mentioned to Mr. Morgan it did appear to be a sensitized paper. Mr. Morgan said, 'No, it is a plain paper'. That is what Mr. Rabbiah said, and I left it at that.

Q. Did you have any further discussion with Mr. Morgan relating to this machine?

A. Yes, was, I think, in April some time, on an occasion, the trip to New York, somebody showed me a machine manufactured in upstate New York. And on looking at it, it appeared to be the very same machine that Mr. Rabbiah had shown us.

Q. What kind of machine was it?

A. It was a photocopy machine called—

Q. Frantz?

A. Yes, made in Gloversville, New York.

Q. Is it F-r-a-n-t-z?

A. Yes, correct.

Q. On seeing this machine, what did you do?

A. I took some descriptive literature on that machine, and when I came back to Toronto I did call Mr. Morgan and tell him I had seen the machine which appears to be the same as Mr. Rabbiah has shown us. And it would, therefore, appear Mr. Rabbiah's machine is not the machine. Mr. Morgan asked me to mail him the leaflets, and I did. And that is the last time I heard about that machine."

There is evidence from other quarters that the Frantz machine succeeded the Savin Sahara in Rabbiah's good graces, and one can only wonder at the foolhardiness of demonstrating it under disguise to the directors of a company which was itself engaged in trying to develop a dry-copy machine, and might be expected to employ people who would be curious and knowledgeable on the subject. Morgan's faith in Rabbiah and the Racan 1015 copier is consistent with his susceptibility to people like Allen Manus, George Weinrott, David Rush and other promoters for whom he, who was capable of giving them real money, was an easy mark.

Involvement of C. P. Morgan

Fascinated though he may have been, there are indications that Morgan knew that he was playing with fire long before Commodore Sales Acceptance assumed the task of financing Racan from Trans Commercial Acceptance. He told the Ontario Securities Commission that he had never had any "share interest" in Racan when he was examined on July 8, 1965.¹ This, like so much of what Morgan said on oath in the course of his numerous examinations, was true only in a literal sense, like the statement made on the same examination that Atlantic Acceptance had never lent any money to Hugo Oppenheim und Sohn. The discovery by the Commission's investigators of six cancelled cheques

¹Exhibit 5112.

among the documents surrendered by Mrs. Morgan, made payable to Carl M. Solomon and marked "Retainer", and each for \$1,000,² led to questions being put to Solomon before the Commission.³ There was a final cheque drawn on the Morgan Trust account of the Royal Bank of Canada account at Freeport Grand Bahama in the amount of \$2,500 on March 18, 1965, marked on the reverse side "deposit only to the credit of Carl M. Solomon (Racan account)". Solomon testified that he had originally borrowed \$12,000 at the Queen and Bathurst Streets branch of the Canadian Imperial Bank of Commerce in June 1962 for the purpose of buying Racan stock, and had bought some 500 shares at a price of \$25 or \$26 per share, under an arrangement whereby Morgan would have a 50% interest in the purchase, and himself and Irwin Singer 25% each. He said that Racan stock was lodged as collateral for this loan, although the liability ledger card in connection with it does not record such shares as security, and if a price in that order were paid the purchase must have been made in May or June of 1963. In any event this speculation was unprofitable, and Morgan appears to have borne considerably more than 50% of the loss and to have made this investment at the very top of the market. As to how far Morgan's answers to the questions put to him at the Ontario Securities Commission were truthful, the following extract is pertinent and decisive:

"Q. . . . Before you go any further down, do you have any share interest in Racan?

A. No. Never had.

Q. Have you ever had?

A. No.

Q. How about notes of Anglo Overseas? We will get to Anglo Overseas in a minute.

A. As far as the Jockey Club is concerned—

MR. GOODMAN: When he says he has never, as I understand it, you are examining him. He said he has never had any share interest in Racan. If you at any time are asking the question of any company, I do wish you would be specific because I don't want any misunderstanding.

Q. There will be no misunderstanding. Right at the moment I am asking Mr. Morgan as to what his personal involvement in any of these companies is. By 'involvement' I mean shareholdings or any other interest you may have through nominees."

The answer remained unchanged.

²Exhibit 3864.

³Evidence Volume 104.

A. G. Woolfrey gave evidence on February 27, 1967 about the circumstances under which Commodore Sales Acceptance assumed the liability of Racan Photo-Copy Corporation to Trans Commercial Acceptance, and the quality of the accounts receivable which were pledged thereafter by the latter to secure steadily mounting loans.⁴ It will be recalled that this took place on September 22, 1964, and the debt to Trans Commercial Acceptance amounted to \$62,692.07 at a time when Racan's indebtedness to a fellow-subsiary of Atlantic Acceptance, Premier Finance Corporation, was in the neighbourhood of \$800,000. The gist of Woolfrey's evidence is contained in a lengthy answer to an introductory question put to him by Mr. Cartwright:

"A. Well, here again, I was called into the office of Mr. Morgan and Mr. Rabbiah was there. He said that he had—Mr. Morgan said that he had just concluded an agreement with Mr. Rabbiah of Racan Photo-Copy Corporation to take over the financing of their accounts receivable. He said that Trans Commercial Acceptance had been up to that time financing their receivables but Racan was having difficulty getting funds for their expansion purposes and Mr. Morgan had agreed to take it on.

It was the first time I met Mr. Rabbiah. The Trans Commercial Acceptance had a general assignment of book debts which Commodore Sales Acceptance took over and Commodore also acquired eighty or \$85,000-worth of accounts receivable from Trans Commercial. The specific assignment of accounts receivable operated on a reasonable scale for the first few months, and then Mr. Morgan agreed to finance some dealer accounts receivable amounting to two hundred-odd thousand dollars.

I might add that when the account was first set up it was agreed by Racan that they would open up a special account in their bank which was to be used for the depositing of receipts from their customers. I was the sole signing officer on that account. The operation was that as the funds were deposited to the account Racan would prepare a cheque in favour of Commodore Sales Acceptance, list accounts receivable that had been paid and write the cheque for the total amount in the bank account. They would bring that down on a daily basis for my signature which was turned over to Commodore Sales Acceptance. Attached to the cheque was a deposit slip stamped by the bank indicating the deposit of X-number of dollars.

When these dealer accounts receivable became due, Mr. Frank Cockburn, who was supervising the account, brought it to our attention and in a discussion with Mr. Rabbiah and Mr. Morgan, Mr. Rabbiah agreed to make a concerted effort to get the dealer account collected; and he so instructed Mr. Lennie to do so.

After that Mr. Cockburn began to investigate the records of Racan and reached the conclusion that all was not proper. He suggested that we circularize the accounts receivable by sending a letter to each of

⁴Evidence Volume 102, pp. 14062-5.

the Racan accounts receivables listed in their records. The letter was to go out on Racan's letterhead and they were to be returned by the customer and held by Racan for Mr. Cockburn each day. They were to be left unopened. This was our only control over the confirmation letters.

The question of whether or not the customers of Racan were to be contacted directly by Commodore was discussed with Mr. Morgan and he agreed to do it the way it was done.

THE COMMISSIONER: In other words, you mean he agreed to do it on Racan's letterhead?

A. On Racan's letterhead, but he impressed upon each and every one of us that the letter, the replies were to be picked up daily and he expected that the envelopes would be left unopened.

Mr. Cockburn's experience in this was that the letters were there all right, but no envelopes. He drew to my attention the fact that the signatures on the letters of confirmation appeared to be quite similar in a number of instances and I collected twelve or fifteen of them and stapled them together and took them to Mr. Morgan's office and asked him if he could see anything unusual about them, without telling him what we had, we suspected. He immediately spotted the similarity of the signatures on the confirmation letters and said, 'It looks as though we have been had.'

Shortly after that we discontinued the financing of Racan but made no attempt to place it in receivership because Mr. Morgan felt that he should give Mr. Rabbiah time to find another source of funds.

Commodore did not finance any receivables of Racan for two months prior to the bankruptcy of Atlantic and collected very little during the period April to June."

Neither Premier Finance nor Commodore Sales Acceptance made further advances to Racan after April 1965, and at June 17 of that year, when Atlantic Acceptance went into receivership, the total indebtedness of Racan to them both was \$1,249,673.39, and the loans made by Commodore Sales Acceptance had almost doubled since the end of 1964.

Forged Cheques and Spurious Orders on the New York Stock Exchange: June 14, 1965

This brief review of the affairs of Racan Photo-Copy Corporation as they affected Atlantic Acceptance and its subsidiaries would not be complete without a more circumstantial account than has hitherto been given of the events of June 14, 1965, when a number of brokerage firms in New York City received spurious certified cheques, accompanied by written orders to buy securities which included shares of Racan and Commodore Business Machines, and which resulted in some cases in substantial, if not heavy loss to the brokers concerned. It was this occurrence which gave the United States Securities and Exchange

Commission jurisdiction to investigate the affairs of the alleged purchaser described as Sassoon's Far Eastern Trust Limited, and resulted in much valuable information accruing to the Royal Commission through the co-operation of this justly famous American agency. Evidence as to what happened was obtained by me from a number of sources, but principally, and with most particularity, from Mr. Peter J. Adolph of the Division of Trades and Markets, voluntarily and on oath on December 8, 1966.¹ The Racan dry-copy machine, no longer given the ill-omened sobriquet of "1015", sprang once more into the limelight as a result of an advertisement which occupied the whole of page 13 of the eastern edition of the *Wall Street Journal* for June 2, 1965. A headline of gigantic proportions read as follows: "The Racan Dry Copier is now ready for delivery and 4 cents a copy on the meter is all you pay—ever!" Below this, in more modest type, were the words "Now in Canada—soon in New York State", followed by "No copier to buy—no copier to rent." On the lower part of the advertisement a comparison of the performance of the Racan machine, both as to simplicity of use and cost, with similar information about "our nearest competitor", appeared in terms highly advantageous to the former, and the advertisement concluded with an invitation to cut out an attached coupon and mail it for further information to "Racan Photo-Copy Corp. 268 Merton Street, Toronto 7, Ontario."² No photograph of the revolutionary machine appeared, but the Racan symbol, with the legend "Technical leader in office equipment", was at the foot of the page. The advertisement was placed by Albert Jarvis Limited of 1000 Yonge Street, Toronto and cost \$5,500 which was in due course billed to Racan. The appearance of this advertisement aroused the interest of officers of the Securities and Exchange Commission in Washington which had over-the-counter trading of Racan stock in the United States under scrutiny because of significant trading there and wide fluctuations in price. Although no marked reaction to the advertisement was detected, there was cause for concern about trading in the company's shares which had shown a remarkable rise in price on the unlisted market in Toronto, from the end of January, when they were 50¢ bid and \$1 asked, to the end of May, when they reached a level of \$8 bid and \$8.50 asked, particularly after the catastrophic decline in price caused by the wide publicity of the New York showing of the Racan 1015 copier in June of 1963.

The next development was the receipt of telephone calls by a number of brokers in New York City, all of whom were members of the New York Stock Exchange, from persons not previously known to them, beginning on June 8 and continuing until June 11. In most cases the person calling identified himself as Norbert Farmer of Sassoon's Far Eastern Trust Limited, and in some cases as Herbert Savage or Walter

¹Evidence Volume 88.

²Exhibit 3642.

Cavin of the same firm. In some instances the caller asked for a particular salesman, and in others for the names of salesmen or customers' men in the firm called, saying that he had been referred to the firm but could not remember specific names. The nature of the deception practised is illustrated by the fact that there was a senior officer of the E. D. Sassoon Banking Company Limited of Nassau in the Bahamas by the name of Norbert Farmer, and this company, which has offices around the world, used in some transactions the name of Sassoon Far Eastern Nominees Limited. On occasion the caller stated that he was in New York on his way from Nassau to Hong Kong, where the E. D. Sassoon Banking Company has a large and busy enterprise. The name of the actual client making the purchase was not revealed, even in response to questioning. The first call was made to the Los Angeles offices of one of the brokers on June 8 by someone identifying himself as a resident of Nassau, but telephoning from Toronto, and stating his wish to buy 10,000 shares of Racan Photo-Copy Corporation at any price under \$10. On this day the bid and asked prices in Toronto were \$9.25 to \$9.75, reaching \$10 on June 10 and 11. Another call was received by the same office in Los Angeles from a self-proclaimed resident of Brooklyn, New York, asking for 5,000 shares of Racan at \$9.50, and a third inquiry came from Mexico City asking for a quotation on the stock. The Los Angeles office refused to execute any of these orders because of a rule in effect on the New York Stock Exchange requiring members to know their customers and to obtain certain information from them before opening an account or executing orders on their behalf. Then on June 14 a large number of New York brokers, upwards of 60 in the words of Mr. Adolph, received letters on stationery of Sassoon's Far Eastern Trust Limited, post-marked Nassau and dated June 12. An example of one of these letters is reproduced:³

"June 11, 1965

H. Douglas Lawrence & Co.,
20 Broad Street,
New York, New York.

Attention: Brian Newman Reference: AF49-985-12

Gentlemen:

Further to our telephone conversation, this is your authorization to purchase for us at market the following securities:

- 50 American Telephone & Telegraph (NYSE)
- 500 Texas Gulf Sulphur (NYSE)
- 1500 Racan Photocopy Corporation Ltd. (Toronto)
- 50 General Motors Corporation (NYSE)
- 1000 Commodore Business Machines (Montreal)
- 500 Jockey Club Limited (Toronto)

³Exhibit 3643.

We are enclosing our certified cheque payable to you. Please register the above securities in the name of Sassoon's Far Eastern Trust Limited at your convenience. Forward your confirmation to us by mail, stating the above reference number.

Yours truly,
 'N. Farmer'
 NORBERT FARMER,
 Vice/President

NF: dk"

This letter was accompanied by what appeared to be a certified cheque for \$60,000. In company with all firms in the New York area which were members of the New York Stock Exchange, the recipient of this letter was circularized by the Securities and Exchange Commission asking for information, and replied as follows on June 24, 1965:⁴

"United States Securities & Exchange Commission

225 Broadway

New York, New York

Re: Sassoons Far Eastern Trust, Ltd.

Ref: B. B. Approv. 71-R-149.2

Gentlemen:

In answer to your requests the following sets forth the series of events with respect to our conversations with Sassoon's Far Eastern Trust, Ltd.

1. On Thursday, June 10th, approximately 2.30 p.m., a Mr. Norbert Farmer called this office and was referred to Mr. William Scheerer, Vice President. Mr. Farmer said something to this effect:

Mr. Farmer: Mr. Scheerer, I have an order for one of your salesmen from one of our clients but I have misplaced his name. Would you please help me identify him?

Mr. Scheerer: Well, we have Torrey Carrington, Ron Shockley, Brian Newman. . . .

Mr. Farmer: Newman, that's it. May I speak to him?

Mr. Newman: Yes?

Mr. Farmer: I am on the way back to Nassau now and we have a customer who has directed us to place stock orders with you, and does not want his name divulged. I am sure you know to whom I am referring.

Mr. Newman: Yes, of course.

Mr. Farmer: Fine. You will receive a bank draft and instructions by letter at the beginning of next week. I'll be in New York in a week or two and will be in to see you then.

Mr. Newman: Very good. I'll look forward to seeing you. Would you mind spelling your name?

Mr. Farmer: F-A-R-M-E-R.

Mr. Newman: Thank you very much.

⁴Exhibit 3644.

2. On Monday, June 14th, we received a letter containing orders to purchase securities and a certified check, copies of which are enclosed.
3. In order to comply with the NYSE 'know your customer' rule and as a matter of routine checking before accepting an order, Mr. Scheerer called the Royal Bank of Canada in New York and talked to a Mr. Utting. Mr. Utting informed Mr. Scheerer that the Royal Bank of Canada did not know the account (Sassoon's) as described, and stated that he had received a few other inquiries, and advised us to turn down the order.
4. Realizing that the check was a forgery and that some sort of manipulation was being attempted, Mr. Scheerer immediately informed Mr. Lee Arning of the New York Stock Exchange as to what had taken place. Mr. Arning advised us that he was aware through calls from other brokers that the checks and orders were forgeries and to turn down the order. Mr. Arning asked for copies of the check and letter.
5. The original check, letter and envelope was given to a representative of the F.B.I. who called on us the next morning.
6. No executions were made by our firm for the account of Sassoon's Far Eastern Trust, Ltd.

Very truly yours,
'Lawrence H. Douglas'
President

LHD:rm
enclosure"

Some brokers did not receive the preliminary telephone calls but only letters such as the one quoted. The aggregate amount of money, represented by the apparently certified cheques of Sassoon's Far Eastern Trust Limited, reported to the Securities and Exchange Commission amounted to \$5,885,000, and the number of shares for which orders to purchase were given in this way amounted to:

Racan Photo-Copy Corporation	127,100
Commodore Business Machines	68,000
Jockey Club	52,700
Texas Gulf	37,000
American Telephone & Telegraph	8,225
General Motors	5,000

In the case of the orders relating to Racan the required purchase at \$10 per share represented somewhat more than \$1,250,000.

Because of the comparatively small number of shares of Racan Photo-Copy Corporation and Commodore Business Machines available for trading, particularly in the case of the former, it might reasonably have been expected that the shares of Racan would have been most affected in price had all the orders received been executed; such well-known and widely held issues as those of American Telephone & Telegraph, Texas Gulf and General Motors would have been undisturbed.

Of the 60 brokers who replied to the inquiries of the Securities and Exchange Commission only 18 executed, or attempted to execute the orders for the purchase of Racan and Commodore shares, and some 21,000 shares of Racan and 10,500 shares of Commodore were bought. Since the cheques were ostensibly drawn on the Royal Bank of Canada in Nassau most of the brokers concerned telephoned the bank's New York agency to make inquiries, most of them being at once suspicious because of the unusual circumstance of a certified cheque accompanying the order. The Royal Bank Agency at once denied that Sassoon's Far Eastern Trust Limited was one of its clients, and upon examining examples of the cheques was able to state that they were obvious forgeries because of the manner of certification and the unfamiliar stamp used. The market had opened on June 14 as usual at 10 a.m., and by 11.30 the word had spread that the orders were fictitious and the cheques forged.⁵

The investigators of this remarkable occurrence were at once confronted with the problem of motive. At first sight it appeared to be a crude attempt to enhance the value of the shares of Racan Photo-Copy Corporation and Commodore Business Machines. If that were so, it was a signal failure, because the discovery of the fraud broke the exiguous market in the shares of Racan to a nominal bid of \$2.50 per share, and trading virtually ceased for two days. The shares of Commodore Business Machines were not so seriously affected and their real decline occurred as a result of the Atlantic default, news of which was known on the following day. The alternative view was that some person or persons unknown relied on the fact that the clumsiness of the attempt would react adversely on the market for these two Canadian securities and drive the prices down. Neither the Securities and Exchange Commission nor the Ontario Securities Commission was able to discover the existence of any significant short position as far as these issues were concerned. A third view, held apparently only by C. P. Morgan, was that a conspiracy existed to damage the efforts to raise money for Atlantic Acceptance in which he happened to be engaged at that particular time in New York. Eugene Last and J. A. Medland both testified to his extreme distress and an initial tendency to blame the collapse of Atlantic upon such an eventuality. It is clear however that the misfortunes of Atlantic were due to other causes of long duration, and were immediately precipitated by the refusal of the Toronto-Dominion Bank to meet its cheque to S.F.C.I. for \$5,000,000; an examination of Morgan's evidence, given subsequently and on many occasions, shows that, upon reflection, he did not nurse his original opinion.

⁵A photographic reproduction of another example of these orders and accompanying cheques, delivered to Shaskan & Co., appears at Appendix Q.

An Explanation of the Mystery

Thus far Mr. Adolph in December 1966; all attempts to solve the mystery, though resolutely pressed, proved to be unsuccessful. Then in March of 1967 the Commission received, through his New York attorneys, Rabbiah's 39-page effusion in which he identified the maker of the rubber stamp, used to simulate the certification stamp of the Royal Bank of Canada on cheques of Sassoon's Far Eastern Trust, as Art Stamp and Seal Company of 120 Church Street in Toronto. The information proved to be correct and the plastic mould in which the stamp had been made was recovered, together with some of the original type and a proof sheet. Further investigation has so far been unproductive, except to raise a question as to how Rabbiah became possessed of such accurate knowledge. His motive in revealing it was clear; he evidently wished to implicate David Rush and Jack Tramiel, according to the general tenor of his narrative, and to establish his own credit as an informer. But Rabbiah's interest in forged passports, false invoices and the cruder apparatus of fraud has long been established, and the use of an obviously false rubber stamp on his first Lebanese passport should make any trained investigator curious. Although in general there were no signs of an organized speculative movement in the market for Racan shares coinciding with the orders mailed from Nassau, there was one man who had given instructions to a friend prior to that time to buy the stock and to sell it at half-hourly intervals at the opening of the market on June 14, and that was Rabbiah himself. In this connection the evidence of Bruce A. Wilson must be briefly examined.

Wilson was an insurance broker in Chicago who did part-time work as a manufacturer's agent and represented a company called Kilbourn Photo Paper between 1962 and 1965 in the sale of some \$80,000 worth of specially-treated reproduction paper to Racan Photo-Copy Corporation. As in the case of most of Racan's accounts, this one fell into arrears, and evidently Wilson persuaded Rabbiah to send him 55 monthly cheques post-dated in favour of Kilbourn, each for \$1,000, to settle the account. This detail has its own importance as will be seen. In May of 1965 Wilson saw Rabbiah in New York for a final discussion of this settlement, and he had dinner with Rabbiah and his wife and members of the latter's family. The meeting was friendly and indeed cordial, and shortly after returning to Chicago Wilson received a telephone call from Rabbiah, asking first how many stock-brokers he knew in Chicago, and then asking him as a favour to buy shares of Racan for which Rabbiah would supply the funds. The reason given for this unusual request was that Rabbiah did not want it generally known that he was buying the stock. There is no evidence, either in Wilson's examination by the Ontario Securities Commission, taken on

September 8, 1965,¹ or in his testimony given at the preliminary hearing,² of any material inducement given to him for performing this service, and, since the charge of defrauding Wilson was not proceeded with, the evidence of Lennie did not deal with the matter. In any event Wilson, through Langill & Co. and Hayden, Stone & Co. in Chicago, and E. H. Pooler in Toronto, bought a large number of shares of Racan, to which must be added some stock purchased in his name and on Rabbiah's instructions through Flood, Whitstock & Co., a Toronto firm since deprived of its registration and privileges, amounting in all to some 14,000 shares. In due course Wilson received a cheque from Rabbiah drawn on the Royal Bank of Canada branch at 131 Bloor Street West in Toronto, dated May 22, 1965, for the sum of \$25,000 which was not sufficient to cover the purchases of Racan stock he had already made, and which failed to clear because of insufficient funds in the account. One would think that the matter might have ended there, but it must be remembered that the post-dated cheques from Rabbiah to Kilbourn Photo Paper had begun to suffer the same fate, and Wilson apparently took the view that Rabbiah was temporarily embarrassed and accepted his assurances that his difficulties would be overcome. He did, in fact, sell a number of shares to meet brokers' demands and then, after repeated telephone calls, he received two cheques dated May 27, one for \$25,000 and one for \$32,000, drawn by K. G. Lennie. These also failed to clear in due course and were succeeded by three more cheques from Lennie, dated June 7, one for \$17,000 and two for \$25,000 each, for which Wilson sought confirmation by telegram, but which also proved to be worthless. The long-suffering Wilson, now faced with very substantial commitments to brokers, next received a telephone call, according to him on the evening of Sunday, June 13, from Rabbiah, telling him to begin selling Racan shares at 9.30 a.m. the following day (presumably Chicago time) and to continue selling at hourly intervals until the stock was disposed of. This he did, but before he had rid himself of more than a fraction of his holdings the market disappeared because of the circumstances already described. Wilson's loss, defrayed by his father-in-law, amounted to roughly \$63,000. He was also confronted with some \$15,000 worth of interest equalization tax imposed by the federal authorities in the United States, in respect of which he subsequently sought Rabbiah's help early in 1966, and received from him an affidavit to the effect that he was acting as Rabbiah's agent in the Racan trading.

Subsequently Rabbiah contended as, according to Wilson, Lennie had threatened he would if any trouble was made for him, that the cheques sent to Wilson were in payment of the indebtedness to the Kilbourn company; this does not explain why they were payable to

¹Exhibit 3798.

²Exhibit 3998.

Wilson. On the evidence available, and in the absence of anything to the contrary, the involvement of Wilson must be judged a particularly cruel deception. That it was deliberate there can be little doubt, since Morton W. Rashkis received the same treatment, on a reduced scale and at the same time, in Toronto, the details of which are contained in his examination by the Ontario Securities Commission taken on March 2, 1966.³ It should be remembered that the attempted coup in New York, however clumsy it might now appear, had real prospects of success because, in view of the escrowed position of the majority of the issued shares of Racan and the fact that a large number of the free shares had been exchanged for notes of Anglo-Overseas Capital Corporation, for which Rabbiah's Mutual Bank and Trust Company had acted as local transfer agent in Nassau, comparatively few shares were in the hands of the public or available for trading. Nor does the clumsiness of the fraud executed ill consist with the character and attainments of the semi-literate Rabbiah whose criminal record shows that his efforts were not always successful.

At the time of writing Rabbiah is still at large and presumably in hiding, although he is known to have obtained, through sources in Toronto, a genuine Canadian passport issued to a false identity. His resources are believed to be considerable; he is alleged to have lent \$2,000,000 to individuals in the United States since his departure from Canada, and to have sold the securities pledged for prices in excess of that amount as soon as he had them in his hands. It is to be hoped that the search for him by law enforcement agencies in Canada and the United States will be vigorously pursued and that he will in due course be brought to trial. Falsification of the books of Racan Photo-Copy Corporation in relation to the loans made to it by O'Neill Finance Company and Premier Finance Corporation, resulting in the production of a false prospectus and the complicity of officers and employees of the lending companies in the deception practised, should not be overlooked when the time comes.

³Exhibit 3785.

CHAPTER XII

The Nevil Group

Neville Levinson

Among the early borrowers from the subsidiaries of Atlantic Acceptance Corporation operated from C. P. Morgan's executive offices in Toronto were a group of companies absolutely controlled by a Canadian citizen, residing usually in Buffalo, New York, by the name of Neville Levinson. Joseph Goldberg, who seems to have been responsible for introducing Eugene Last and George H. Weinrott to Morgan, according to his own testimony performed the same office for Levinson as early as 1956 or 1957, but it may well have been later.¹ Levinson himself said that Goldberg made the introduction in 1958.² Neville Levinson was a salesman in that period after the last war when selling, in a community for many years starved of consumer goods, was a profitable occupation. He specialized in selling plastic articles to advertising agencies and to manufacturers as aids to merchandising, and patented certain plastic devices of his own invention, the principal item being a tiered display stand known as "Spacenaut". At his right hand, and associated with him in all the companies of the Nevil group, was a Miss Paula Drew, well-known to viewers of television in the Buffalo area from her appearances in commercial advertising in the early days of transmission. Mr. R. W. Scott of Clarkson, Gordon & Co. analysed the financial information available for these companies, a considerable task since no audited financial statements for any of them have been found, with the exception of the report of Riddell, Stead, Graham & Hutchison, chartered accountants of Toronto, who prepared combining financial statements for the seven

¹Exhibit 3713.

²Exhibit 3697.

months' period ended February 28, 1966 but did not examine the accounts of the companies from inception until July 31, 1965.³ Mr. Scott was compelled to rely on the working papers of this firm used to prepare United States income tax returns⁴ throughout the period 1959 to 1965, the records and files of Commodore Sales Acceptance Limited, Commodore Factors Limited, Adelaide Acceptance Limited and The Clarkson Company Limited, and such banking documents as existed in Ontario to reconstruct their financial history. The loans from Atlantic subsidiaries exceeded \$2,000,000 and the loss was virtually complete, as will be seen. A brief account of what transpired may be appropriately placed in juxtaposition to the story of Racan Photo-Copy Corporation Limited, since the manufacture of invoices played a large part in procuring loans and inflicting losses on a scale which can only be explained by complicity between lender and borrower.

Five companies incorporated at the instance of Neville Levinson must be considered. The first in point of time was Nevil Plastics Limited, incorporated as a private company in Ontario on November 25, 1948,⁵ and principally engaged in the distribution of plastic products rather than their manufacture. The second was Nevil Plastics Inc., a New York State company incorporated on April 9, 1957 with its head office in Buffalo; it was engaged in the manufacture and sale of various plastic products. The third company was Nevil Enterprises Inc., also a New York State company incorporated on November 20, 1961, and it took over the business of Nevil Plastics Inc. which thereafter became dormant. The fourth was Canadian Nevil Enterprises Limited, incorporated as a private company in Ontario on October 1, 1962,⁶ which for a short time manufactured plastic paddle boats for a Morgan enterprise known as Fun-A-Marin Limited, and the fifth and last in point of time was Tools and Molds Inc., another New York State company, formed in May 1963 to acquire the tools and moulds of Nevil Enterprises Inc. and lease them back to the vendor. Of these five companies Nevil Enterprises Inc. was the main operating company at the time of the Atlantic collapse and continued to operate independently until August 24, 1967 when it was placed in bankruptcy. Levinson was at all times the principal, and indeed dominant shareholder of all the companies and in the case of Nevil Enterprises Inc. owned all the shares. As an indication of the scarcity, and perhaps non-existence of records, the only evidence on the subject of officers and directors was provided in the case of Nevil Enterprises Inc. from a direction to the Bank of Nova Scotia⁷ in which Neville Levinson was shown as president, Powell Morgan as vice-president, Neville

³Exhibit 2512.

⁴Exhibits 2480-9.

⁵Exhibit 422.

⁶Exhibit 379.

⁷Exhibit 2491.

Levinson as treasurer and Paula Drew as secretary, all being directors, and in the case of Tools and Molds Inc. a "Certification of Officers" sent to the Chemical Bank New York Trust Company and dated May 15, 1963 showing Levinson as president, Morgan as vice-president and Miss Drew as secretary.⁸

Performance of the Nevil Companies

A schedule of comparative financial statements for Nevil Plastics Limited, which has a year-end date of February 28, shows the situation of the company at that date in each year from 1961 to 1965 and additional figures at July 31, 1965.¹ The only years in which the company appears to have been actively engaged in business are 1961 and 1962, sales for which are shown. The total capital investment was \$30 throughout and at the beginning of the year ended February 28, 1961 there was a deficit of \$22,678; during the course of that year there were sales of \$11,683 and a net loss of \$12,488. Loans payable to the Atlantic Acceptance companies were shown as \$1,876 in 1961 and \$1,692 in 1962. During the year ended February 28, 1963, when the company had ceased to be active, Atlantic loans increased to \$279,375 and in the year ended February 28, 1964 to slightly over \$420,000, so that by July 31, 1965 Nevil Plastics Limited owed the Atlantic group \$401,489. The deficit at February 28, 1965, when the loans stood at \$382,371, amounted to \$73,157. No interest was charged as an expense and, since Nevil Plastics Limited borrowed from the Atlantic companies to lend in turn to Nevil Enterprises Inc., the accountants seem to have charged interest expense on all the loans to the latter, so that the interest charge and the interest receivable in the case of Nevil Plastics Limited cancelled each other out. The loans receivable from Nevil Enterprises Inc. were the only asset of Nevil Plastics Limited at February 28, 1965 and amounted to \$329,434.

A similar schedule of comparative financial statements as at December 31 for the years 1959 to 1964 and at July 31, 1965 shows the situation of Nevil Plastics Inc.² This company was active from 1959 to 1962, but for only part of the latter year during which it sold all its assets to Nevil Enterprises Inc. which thereafter was the operating company of the Nevil group. After this Nevil Plastics Inc. was inactive and throughout its life had a share capital of \$3. It was evidently the earliest borrower of consequence from the Atlantic companies to which it owed \$108,724 at the end of 1959. By the end of 1961 these loans had increased to a total of \$536,940 and from there on it showed no indebtedness to them. It recorded in 1962 a profit of \$229,417 from the sale of its assets to Nevil Enterprises Inc. which was used to discharge its liabilities to the Atlantic companies, but which did not improve the position

⁸Exhibit 2492.

¹Exhibit 2490.

²Exhibit 2493.

of the latter since the loan was taken over to its full extent by Nevil Enterprises Inc. after the purchase. After this the only asset of Nevil Plastics Inc. was \$47 in the bank up until the end of 1964, and a loan due from Neville Levinson, first contracted in 1959 in the sum of \$10,000 which grew to \$197,016 at the end of 1962 and \$213,946 at July 31, 1965. The company accumulated deficits from 1959 onwards in every year except 1962, when it made a paper profit on the sale of its assets to Nevil Enterprises Inc. producing a net profit for the year of \$74,564.

Since Nevil Enterprises Inc. was the main vehicle of Levinson's attempts to manufacture plastic articles, a schedule of its comparative financial statements from the opening balance sheet at August 1, 1962 and for the years ended July 31, 1963 to 1965 is reproduced opposite.³ The share capital shown at \$1,000,000 was recorded as issued in exchange for patents and Canadian Industrial Design registrations assigned by Levinson, but no cash was invested. It will be noted that at the end of the first year of operation July 31, 1963 sales amounted to \$277,804 against a direct cost of sales of \$260,969 on which the company incurred a net loss of \$210,983. Characteristic expense items are Levinson's salary of \$20,000, his travel expenses of \$34,183, Miss Drew's salary of \$31,200 and interest expense of \$60,244. Miss Drew had an office force of no more than two persons to supervise; among records subsequently recovered by the Commission's investigators appear cheques and bank statements indicating that she received \$1,000 a week from a company called Nevil Publishing Company about which nothing is known, except that it was apparently engaged in supplying encyclopaedias and similar books to food stores in supermarkets, was financed by Nevil Plastics Inc. with Atlantic money, and that these payments amounted between May 1961 and January 1962 to \$33,400. At the end of the next year Nevil Enterprises had incurred a loss of \$394,285 on gross sales of \$161,596, the direct cost of which was \$155,151. The Levinson and Drew salaries are the same, and Levinson's travelling expenses about the same, but interest expense has risen to \$149,633. These two salaries plus Levinson's travelling expenses amount to approximately 50% of the gross sales. At July 31, 1965 the company recorded a loss of \$776,122, with gross sales of \$291,781 and direct cost of sales of \$463,159. It is unusual, to say the least, to find cost of sales at 150% of sales themselves, and this inversion may be explained by the fact that the value of inventory at the end of July, 1964 was \$301,000 compared with \$186,959 at the end of the previous year, but at July 31, 1965 this figure had declined to \$106,106. The drop of almost \$200,000 suggests over-valuation and that the auditors "wrote it down" in preparation for a 1965 statement. It may also be observed that at the beginning of the year

³Exhibit 2494.

NEVIL ENTERPRISES INC.
COMPARATIVE FINANCIAL STATEMENTS
AUGUST 1, 1962 AND JULY 31, 1963 TO JULY 31, 1965

<i>Balance Sheets</i>	<i>August 1</i>	<i>July 31</i>		
	1962	1963	1964	1965
Assets				
Cash	\$ 220	\$ 200	\$ 200	
Accounts receivable	90,100	184,279	72,213	\$ 20,404
Inventory	198,317	186,959	301,000	106,106
Prepaid expenses	5,250	5,755	3,888	3,389
Due from N. Levinson				16,335
Fixed assets	345,477	65,870	73,159	68,693
Patents	1,000,000	1,000,000	1,000,000	1,000,000
Totals	<u>\$1,639,364</u>	<u>\$1,443,063</u>	<u>\$1,450,460</u>	<u>\$1,214,927</u>
Liabilities, Capital and Deficit				
Bank overdraft		\$ 45,524	\$ 14,821	\$ 11,766
Accounts payable	\$ 7,795	88,465	64,627	117,125
Due to Atlantic Acceptance group	527,620	462,333	975,973	1,158,679
Due to associated companies—net	103,949	57,724	307	308,747
	639,364	654,046	1,055,728	1,596,317
Share capital	1,000,000	1,000,000	1,000,000	1,000,000
	1,639,364	1,654,046	2,055,728	2,596,317
Less deficit		210,983	605,268	1,381,390
Totals	<u>\$1,639,364</u>	<u>\$1,443,063</u>	<u>\$1,450,460</u>	<u>\$1,214,927</u>
Profit and Loss Statements				
Sales	\$ 277,804	\$ 161,596	\$ 291,781	
Cost of sales	260,969	155,151	463,159	
Gross profit or (loss)	16,835	6,445	(171,378)	
Salaries—N. Levinson	20,000	20,000	20,000	
— P. Drew	31,200	31,200	31,400	
Interest expense	60,244	149,633	334,727	
Travel—N. Levinson	34,183	36,460	20,074	
Bad debts	3,066	42,474	16,833	
Other expenses	79,125	120,963	181,710	
	227,818	400,730	604,744	
Net profit or (loss)	(210,983)	(394,285)	(776,122)	
Deficit—beginning of year		210,983	605,268	
Deficit—end of year	<u>\$ 210,983</u>	<u>\$ 605,268</u>	<u>\$1,381,390</u>	

which ended on July 31, 1963 Nevil Enterprises owed the Atlantic companies \$527,620, a figure which had declined by some \$65,000 at the year-end, but in the face of the lamentable performance illustrated above these loans had more than doubled by the end of the following year and at the same point in 1965 had reached the staggering total, in the case of this company alone, of \$1,158,679. Even the \$308,747 shown as owing to "associated companies" had been lent to the latter on C. P. Morgan's instructions.

Figures for Tools and Molds Inc. were available for April 30, 1964, apparently the end of the first year of operations, and for July 31, 1965.⁴ At the former date nothing was shown as invested in capital stock and there was already a deficit of \$37,476. The company had two assets in the shape of \$91,500 due from Nevil Enterprises and the moulds and dies purchased from that company and valued at \$256,000. Tools and Molds at this date owed Commodore Factors Limited \$384,976, and recorded interest from Nevil Enterprises of \$14,000 and rental income from moulds leased to the same company of \$72,500, the loss equalling the amount of the deficit and being simply a loss after depreciation, assuming that Nevil Enterprises paid the mould rental. As at July 31, 1965 the capital stock account shows \$1,000 invested, offset by a receivable due from Neville Levinson of \$1,000 in respect of a subscription for shares which he had not paid. At that point the debt to the Atlantic companies was \$470,755 and the deficit \$41,457. Although no information from the accountants' working papers was available for a calculation of profit and loss, the company apparently lost some \$4,000 in the course of fifteen months.

No financial information whatsoever was found in connection with Canadian Nevil Enterprises Limited and up to December 5, 1965 the company had never filed a return under the Corporations Information Act to the Provincial Secretary.⁵ Accordingly Mr. Scott prepared a schedule entitled "Nevil Group—Combined Financial Statements—1961-1965" which is appended as Table 51,⁶ from which Canadian Nevil Enterprises alone is excluded. Although each column is headed by a year from 1961 through to 1965, no year-end date is shown at which the figures might be considered correct. The effective dates of the financial statements for each of the companies combined are set out in the right hand columns; for instance for 1961 that of Nevil Plastics Limited for February 28, 1962 was combined with that of Nevil Plastics Inc. for December 31, 1961. Thus under the column headed "1961" there are shown the figures which would appear if in fact both companies concluded their fiscal years at December 31. Because of the unsatisfactory state of the records and the close relationship of the Nevil group of

⁴Exhibit 2495.

⁵Exhibit 379.

⁶Exhibit 2496.

companies, this treatment appeared to be the most practical way of producing a conspectus of their affairs. In short, except for the 1965 figures, all of which were available for July 31, the schedule is no more than closely approximate to results which would have been shown had the companies' books been available, with all their results calculated as at the end of the calendar year. In the combined financial statements the treatment of inter-company accounts has the effect of overstating the combined assets, with the complementary effect of understating the deficit. For example, one company having an earlier year-end might show that it was owed \$40,000 by another with a later year-end. After showing the first company with a receivable of \$40,000 from the second, a situation might arise, on considering the second company's financial statement at the date of its later year-end, which would produce in turn a receivable of \$80,000 from the first company. In that case the combined total would be \$120,000 and would show as an asset under inter-company accounts in that amount. In most cases the inter-company accounts end up as a net debit which has to be shown as an asset. In spite of this inevitable distortion, and its tendency to produce a more favourable appearance than the facts justify, it will be seen that in the year 1961 in which Nevil Plastics Limited and Nevil Plastics Inc. were the only two companies combined, with assets of \$558,663, they incurred a net loss of \$73,485 with a closing deficit of \$155,233. The combined share capital was \$33, and the Atlantic companies had lent a total of \$538,632 on the security of assignments of accounts receivable and inventories having a total book value of only some \$225,000. In 1962 Atlantic loans increased to \$806,995 and the book value of this security, assuming that the lending companies had a charge upon inventory of which there is no documentary evidence, was virtually the same at \$288,417. The combined net loss in this year was \$177,581; total assets were \$1,539,537, of which \$1,000,000 came from the value assigned by Nevil Enterprises Inc. to patents acquired from Levinson. Although the travel expense item is shown as "principally N. Levinson", for the later years it is all attributable to him. In addition to receiving his salary through the period covered before and including 1961, he had borrowed a sum amounting to \$137,864 for which his companies had no security, nor even promissory notes, and in 1962 these loans had increased by some \$60,000. A word should be said about the apparent drop in salaries in 1962, due to the date at which the statements were combined covering only part of the year for Nevil Plastics Inc.; Levinson's own salary did in fact drop to \$20,000 and remained there thereafter, but his loans from the companies had increased by July 31, 1965 to \$231,281. Levinson was questioned about these in the evidence which he gave before the Commission on July 15, 1966 and an excerpt from the transcript will be quoted.

Atlantic Loans' Sharp Rise in Face of Heavy Losses in 1964-65

In 1964, with a combined net loss for the Nevil group amounting to \$436,005 bringing the total deficit to \$980,482, the Atlantic loans increased by over \$400,000 to \$1,743,320 similarly secured, the book value of the security being only about \$475,000 and, by that time, less than one-third of the aggregate of the loans. During the year gross sales had in fact declined to \$248,096, but interest expense, not unnaturally, increased to well over three times that of the preceding year to \$209,609. By July 31, 1965 the Nevil companies owed to all the subsidiaries of Atlantic Acceptance lending to them the large sum of \$2,030,923, and the latter had just the same security as they had enjoyed since 1963, the assignment of accounts receivable and inventory and a charge on the moulds and fixed assets of the group acquired in that year, representing a book value of approximately \$157,000. *The Atlantic loans were therefore about thirteen times the apparent security, and the borrowers incurred a combined loss at that point of \$776,103 with an accumulated deficit of \$1,756,585.* Moreover, apart from the \$1,000,000 worth of shares issued for patents by Nevil Enterprises Inc., the combined equity would have stood at \$1,033 if Neville Levinson had paid the \$1,000 which he owed to Tools and Molds Inc. This great loss in the first seven months of 1965 was attributable in part to the fact that the accountants were preparing statements for July 31 with greater care than in previous years, and were taking up interest, as they told Mr. Scott, really applicable to earlier periods and including it as a contemporaneous charge. Interest expense for instance was shown as \$334,727 compared with \$209,609 in 1964, but the amount of the loans did not increase to a comparable extent; the downward adjustment of the value of the inventory has already been mentioned. Consideration of the combined financial statements was summarized by counsel and Mr. Scott at this stage of the evidence in the following exchange:⁷

"MR. SHEPHERD: I would like briefly to review the information set out on this schedule, Exhibit 2496. At the end of 1961 what is the aggregate deficit of these companies?

A. The deficit stands at \$155,233.

Q. And to what amount had that deficit risen by the end of July, 1965?

A. \$1,756,585.

Q. To what extent had the Atlantic loans risen in that period?

A. They rose from \$538,632 in 1961 to \$2,030,923 in 1965.

Q. And I take it the Atlantic loans rose by approximately one and a half million dollars, is that correct?

A. Yes.

⁷Evidence Volume 47, pp. 6601-3.

Q. And the deficit of the companies increased by approximately how much?

A. Approximately \$1,600,000.

Q. During that same period from 1961 to 31 July, 1965, what increase occurred in the loans to Mr. Levinson?

A. They rose from \$137,864 to \$231,281.

Q. Can you state how these loans arose on the books?

A. As I understand it, Mr. Levinson would merely withdraw money from the bank account, and at the end of the year the accountants would total up the sum withdrawn, deduct his salary from it, and record the remainder of it as an increase in his loan.

Q. What is the equity position of these companies taken as a group, from 1961 forward, if you exclude the million dollars value accorded to the shares which were issued in return for a patent?

A. It remains at \$33 up until 1965, when it becomes \$1,033, that one thousand dollars coming from the Tools and Molds issue of shares which were never paid for, so it basically remained at \$33.

Q. Is there also a deficit in equity?

A. Ignoring the million dollars, there is always an equity deficit, yes.

Q. At 31 July, 1965, if one includes the million dollars, what is the position so far as equity is concerned?

A. There is an equity deficiency of about \$755,000.

Q. Would it appear that these companies, taken as a group, were throughout this period insolvent, if one excludes the million dollars for the patent?

A. Yes, I think that would be a warranted conclusion, certainly in the later years."

Factoring Procedure of Commodore Factors

The progress and extent of the Atlantic loans derived from an examination of the records of Commodore Sales Acceptance, Commodore Factors and Adelaide Acceptance is illustrated on Table 52,¹ entitled "Nevil Group—Summary of Loans Outstanding at July 31, 1959 to 1965". The specific date of July 31 in each year was selected because it was the end of the fiscal year for Nevil Enterprises Inc., the primary operating company, and the books of the lending companies are sufficiently detailed so that the information can be summarized with accuracy. The first loan was described as a chattel mortgage loan of \$11,000, with interest at the rate of 2% per month, made on April 13, 1959, but subsequently, on June 24 of that year, Commodore Sales Acceptance began factoring the accounts receivable of Nevil Plastics

¹Exhibit 2497.

Inc. a task which was taken over by Commodore Factors in 1961. The procedure has been described earlier in this report, but since a wealth of documentary evidence was introduced in connection with the factoring arrangements that existed between the Nevil companies and particularly Commodore Factors, and so much turned in this particular case on the *minutiae* of the operation, it is appropriate to refer to it again in this context. An example of the Commodore Factors "Accounts Receivable Assignment Schedule", dated September 11, 1964, was entered in evidence² and this had been completed by Nevil Enterprises Inc. and signed for the company by Neville Levinson as president. On its face is a list of the debtors with the date of the invoice, the invoice number, the name of the customer and the amount of the debt, and at the bottom left hand corner a calculation is made by Commodore Factors showing the amount of the reserve of 10% retained by it, a 2% service charge calculated on the gross amount of the invoices assigned, which Commodore Factors took at once into income, and a third figure marked "pay customer", representing the net amount after these deductions. On the reverse side of the form Nevil Enterprises, in addition to executing the assignment and transfer of the accounts listed by the hand of its president, Neville Levinson, makes certain representations in the following terms:

"Without limiting the generality of the foregoing, the Assignor warrants and represents as to said accounts or claims: that the same are bona fide and existing obligations of the Assignor's customers arising out of the sale of merchandise or services by the Assignor in the ordinary course of the Assignor's business, free and clear of all liens and encumbrances and owned by and owing to the Assignor without defense, offset or counterclaim; that there are no disputes or claims with respect thereto; that the merchandise represented thereby has been delivered to and accepted by the customers therein named; that no payments have been made thereon; that the terms of credit with respect thereto are correctly set forth in said schedule, and that proper entries have been made on the books of the Assignor disclosing the within assignment and transfer thereof to Commodore."

Copies of the invoices themselves were attached to this document, and in this particular case Commodore Factors withheld \$5,000 of the net amount of \$17,556.15 to be advanced to Nevil Enterprises and credited the sum withheld to an instalment loan account with that company. It further deducted \$2,547.65 on account of interest due from the Nevil companies on two loans other than the instalment loan outstanding, so that Nevil Enterprises only received \$10,000 for very nearly \$20,000 worth of receivables. In order to ensure remittance by Nevil Enterprises

²Exhibit 2498.

when it was paid by its customers, Commodore Factors opened a bank account in the name of the company at the main branch of the Bank of Nova Scotia in Toronto. Nevil Enterprises would endorse its customer's cheque which would be deposited in this account by Commodore Factors, and thereafter only Commodore Factors could make withdrawals, and deposit the funds to its own credit at the same bank. This use of a transfer account was referred to as "non-notification" procedure by Woolfrey, by which the customer of Nevil Enterprises remained unaware that the company's accounts receivable had been assigned, a common practice in factoring. Since the obligation lay upon the company assigning the accounts to endorse all cheques received, the success of the procedure depended to a vital extent on the good faith of the Nevil companies.

The books of the two Commodore companies show that the lending company would open a ledger sheet for each of the borrower's customers and would record each invoice assigned as an outstanding item. When the customer paid the Nevil company and it in turn endorsed the cheque, receipt of funds would be credited to the customer's account, producing a new balance in respect of the invoice. There were naturally a very large number of these sub-ledger sheets and three of them were selected for special study because of the apparently substantial business done by Nevil Enterprises with the customers concerned which were Hiram Walker Inc.,³ the Nestlé Company⁴ and E. R. Squibb & Sons.⁵ When Nevil Enterprises forwarded a payment to Commodore Factors it included a remittance advice in which it would set out the amount of the assignment and the amount of the invoices paid, together with the invoice number; from this Commodore Factors would be able to post a receipt of funds in the appropriate account and mark it off against the relevant invoice. It was therefore possible at all times to see from the books of the lending company what invoices were assigned and what was subsequently paid, and to compare the funds remitted to Commodore Factors for instance with what Commodore Factors lent against the assignments. Periodically Commodore Factors would send a list of the outstanding accounts to Nevil Enterprises, a particularly important one being headed "Nevil Enterprises Accounts Receivable Ending February 28, 1965", a copy of which was found in the records of Commodore Factors.⁶ This three-page document is divided into columns to show first the name of Nevil Enterprises' customer and the total amount assigned, and thereafter figures under the heading "Current", "30 days", "60 days" and "Special Dating". This was the form for aging accounts receivable described by Woolfrey, who testified specifically about the transactions of the two lending companies of which he was the treasurer on June 22,

³Exhibit 2499.

⁴Exhibit 2500.

⁵Exhibit 2501.

⁶Exhibit 2502.

1966,⁷ and described the "Special Dating" category as including all those receivables more than 90 days overdue. The total of accounts receivable by Nevil Enterprises and held by Commodore Factors on February 28, 1965 against which payment had not yet been received, and which agrees with the total of the sub-ledgers of Commodore Factors for the accounts listed, was \$734,756.01, of which \$611,001.61 was shown as being more than 90 days old.

Instalment Loans by Commodore Sales Acceptance and Adelaide Acceptance

It will be noted from perusal of Table 52 that after July 31, 1959 Commodore Sales Acceptance continued to lend increasing amounts to Nevil Plastics Inc., in particular until 1961 when its United States' dollar lending was taken over by Commodore Factors, a New York State corporation. When this occurred Commodore Factors opened an instalment loan account, transferring or closing out other loan accounts in the amount of \$300,000, including unearned interest of \$100,000. This was a five-year loan with interest at 10% per annum on the "add on" principle, producing an effective rate of about 20%. It was apparently unsecured, although the debt represented by it had been previously on a demand basis. During the period ended July 31, 1962 Nevil Enterprises entered the picture and began factoring its accounts receivable in place of Nevil Plastics Inc. on July 4, 1962. In July and August 1962 Adelaide Acceptance began to finance the Nevil companies for the first time, and it made instalment loans in the gross amount of \$345,000 to Nevil Plastics Limited of which \$45,000 was treated as deferred revenue, the whole amount being repayable in thirty instalments of \$11,500 a month with an effective rate of interest of about 12%. Nevil Plastics Limited re-loaned the money to Nevil Plastics Inc. just before Nevil Enterprises became the chief operating company, and Nevil Plastics Inc. used \$216,000 of the loan to make payments back to Commodore Factors amounting to a reduction of \$200,000 in U.S. funds of its debt to that company. The effect of this transaction was that Adelaide assumed \$216,000 of the loan which Commodore Factors had been making, and the net payment deposited in the account of Nevil Plastics Inc. at the Eglinton Avenue and Castle Knock Road branch of the Bank of Nova Scotia in Toronto on July 6¹ was \$269,783.01, or was what was left after Adelaide Acceptance had made deductions from the principal amount of \$300,000. These were authorized by a letter addressed, not to Adelaide Acceptance, but to Atlantic Acceptance Corporation at 100 Adelaide Street West in Toronto, signed for Nevil Plastics Limited by N. Levin-

⁷Evidence Volume 47.

¹Exhibit 2504.

son.² They consisted of repayment of a note due from Nevil Plastics Limited in the amount of \$20,000 with interest thereon of \$105.21, and \$10,000 for the account of Neville Levinson with interest of \$111.78.

Levinson's \$40,000 "Investment"

By having Nevil Plastics Limited interposed as borrower between it and Nevil Plastics Inc. Adelaide Acceptance was deprived of the covenant of an operating company, and Nevil Plastics Inc. itself was to yield that function to Nevil Enterprises before the month was out. The former company's disposition of the Adelaide funds now at its disposal revealed a transaction as questionable as any in C. P. Morgan's relationships with the borrowers of Atlantic money. On July 6, 1962, just three days prior to the payment of \$216,000 of these funds to Commodore Factors, the Nevil Plastics Limited bank account ledger shows a withdrawal of \$40,000. Among the accountants' working papers was found a memorandum on the stationery of Nevil Enterprises Inc. described as "from the desk of: Neville Levinson".¹ This, which was identified by Levinson as having been written in his handwriting for the information of the accountants, summarizes the transactions between Nevil Plastics Limited and Adelaide Acceptance, listing the cheques from Nevil Plastics Limited and Nevil Plastics Inc. to disburse the loan, and concludes by noting a cheque from "N.P. Inc. to N.L.—40,000" and a cheque from "N.L. to Annett & Co. (re Atlantic Accep. stock)—40,000". The withdrawal of \$40,000 from the Nevil Plastics Inc. account was matched by a deposit of the same amount on the same date in Levinson's personal account in the same branch,² and the ledger for this account shows \$40,000 paid out on July 10. The records of Morgan's account with Annett Partners Limited³ show a credit of \$40,000, dated July 6, with the notation "N. Levinnis", evidently referring to a cheque from Levinson which cleared to his account with the Bank of Nova Scotia on July 10. This documentation is perhaps unnecessary, because Levinson acknowledged having made the payment to Annett Partners Limited in the evidence which he gave to the Commission, although he professed to be unaware of the fact that it was treated in this way by the Toronto brokers. The payment produced a credit balance in Morgan's account with them of \$21,557.88; it had been placed in a debit position on July 4 by the purchase of 1,000 shares of Atlantic Acceptance at \$17.75 per share for \$18,050. On July 16 there is an entry in this account recording the delivery of 1,000 Atlantic shares, which proved on inquiry to have been made to Jenkin, Evans & Co. for Morgan's account at that

¹Exhibit 2509.

²Exhibit 2505.

³Exhibit 2506.

⁴Exhibit 477.

house. By cheque No. 10149 of the Annett firm the amount of \$21,807.88 was paid out to Morgan on August 2, and in November the 1,000 Atlantic shares plus an additional 200 were apparently delivered to him by Jenkin, Evans & Co. It would not appear that these 1,000 shares from their destination, denomination or date of purchase can be identified with the reference in Levinson's memorandum. There is no evidence of any securities having been delivered to Levinson and he was never shown on the records of the transfer agent as an Atlantic shareholder.

Some light was cast on this transaction by Neville Levinson himself which did nothing to dispel the shadow of corruption that lay across it. Because of representations made on his behalf at the conclusion of Mr. Scott's evidence he did not then testify, and both he and his counsel, Mr. James Karfilis, had three weeks in which to consider the evidence on this and other matters. On July 15, 1966, when he did testify, the matter of this \$40,000 payment was raised early in the proceedings. He said that he had a number of conversations with C. P. Morgan about buying shares of Atlantic Acceptance and that he wanted to cement ties between it and his companies by doing so. He had sent a cheque for \$40,000 to Annett Partners Limited and had simply left it up to Morgan to arrange the purchase. Annett & Co. had been Morgan's choice of broker because Levinson, as he said, did not know a single brokerage firm in Toronto. The examination continued thus:⁴

"Q. Did you communicate with Annett Partners at all?

A. No, I didn't.

Q. At any time?

A. No.

Q. So, you sent your cheque. To whom did you send your cheque?

A. By mail.

Q. To whom?

A. To Annett and Company.

Q. Getting the address from Mr. Morgan, I suppose?

A. Yes.

Q. And what did your covering letter with the cheque say?

A. I can't—I would have to check my file. But it was merely sent down, if I remember, to Annett and Company.

Q. I put it to you, Mr. Levinson, that we have checked and there does not appear to be a letter in Annett Partners' hands relating to this transaction. Is it possible you just mailed the cheque to Annett's without a covering letter?

A. It is possible, but I would probably put on the back of the cheque what the amount was for.

⁴Evidence Volume 55, pp. 7491-7.

Q. Where is the cheque now?

A. I imagine it must be in their files in Buffalo.

Q. It is your own personal cheque?

A. Yes, I keep my personal—

Q. In Buffalo?

A. In Buffalo or Toronto. I would have to—

Q. Would you be good enough to seek out the cheque for us?

A. Certainly.

Q. And advise us, and we would be glad to go and pick it up?

A. I would be glad to.

Q. You mailed the cheque to Annett Partners for \$40,000, and there may or may not have been a covering letter; is that right?

A. That is correct.

Q. Now, no doubt you were very conscious of the market price of the shares. What was the market price?

A. If I remember it was around 19, 18, \$19.00, somewhere around there.

Q. How did you pick out the sum of \$40,000?

A. That is the amount that I felt I could invest in it at that time.

Q. Is this not an extremely unusual way in which to purchase shares? Would you not agree you would normally give your instructions to the broker to purchase so many shares, and when you received the confirmation notice you would pay the precise sum involved?

A. I don't know what the normal way is, I never buy stock.

Q. Did you want to buy 2,000 shares?

A. About \$40,000 worth, whatever that amounted to.

Q. But it could be preference shares or it could be common shares; is that right?

A. Yes, whatever Mr. Morgan suggested would be the best.

Q. So, you mailed your cheque, and, of course, it would come to your attention when you saw your bank statement later that the cheque was cashed?

A. That is right.

Q. Now, describe, if you will, all the numbers of times you must have approached Annett Partners to find out how many shares you had bought with this?

A. I didn't approach them at all.

Q. Did you get any shares?

A. No, I didn't.

Q. Did you get your money back?

A. No, I didn't.

Q. On how many occasions were you in touch with Annett's to find out what had happened to your \$40,000?

A. I wasn't in touch with them at all.

Q. Were you in touch with Mr. Morgan?

A. No, as a matter of fact, I wasn't. Mr. Morgan was a friend of mine, and still is a friend of mine. And I assumed that at some time I would get my stock when their loans were reduced, probably.

Q. Was there some discussion to the effect the money was to be held by Mr. Morgan or by one of his companies until you reduced your loan?

A. No.

Q. The only discussion was that you were paying \$40,000 to Annett's and you wanted \$40,000 worth of stock; is that right?

A. That is true.

Q. Were Annett's to go out on the public market and buy this stock?

A. I didn't know how they were going to do it. Actually I left it up to Mr. Morgan to arrange the complete transaction.

Q. Then, when you didn't get the stock or the \$40,000 you must have been greatly disturbed, Mr. Levinson?

A. I wasn't disturbed. I assumed when Mr. Morgan had the stock, was holding it in trust for me.

Q. Did you ask him?

A. No, I don't believe I did. But I assume he was, otherwise he would have told me that they hadn't received the money.

Q. But you were dealing with Annett's, and you paid Annett's, why would you assume that Mr. Morgan would have your stock?

A. Because I had spoken to Mr. Morgan, I didn't get in touch with Annett and Company. And as far as I was concerned he arranged the complete transaction of the stock, and otherwise.

Q. Then, Mr. Levinson, do you assert on your oath that out of a loan of \$300,000 made to one of your companies \$40,000 was paid into your bank account, that you discussed by telephone with Mr. Morgan the wish you had to purchase some Atlantic shares, but you didn't specify what class of shares, and you asked Mr. Morgan to suggest a broker, and he suggested Annett Partners, whereupon you mailed them a cheque for \$40,000; is that correct?

A. Yes.

Q. Then, you didn't receive any shares, you didn't get the money back, and you didn't ask either Annett Partners or Mr. Morgan what had happened to your money or your shares; is that right?

A. I can't recollect if, if I asked Mr. Morgan at this time. I might have mentioned it to him, but I can't recollect.

Q. Now, the evidence is when Annett Partners got your money they simply credited it to Mr. Morgan's account and Mr. Morgan in due course obtained the money or securities purchased with that money?

A. I didn't know that.

Q. When did you first learn that?

A. When I read the transcript last week?

Q. You must have been very distressed?

A. Yes, I was."

When pressed further by Mr. Shepherd, Levinson said that he had made no inquiry of Annett Partners, even after the collapse of Atlantic, and he asserted that there had been a definite arrangement with Morgan that he would hold the stock for him in trust. The absence of any inquiry made from anybody in the interim as to the actual disposition of the funds, and of the whereabouts of the stock, engaged counsel's attention for some time, and after further questioning the examination on this point concluded as follows:⁵

"MR. SHEPHERD: When you were negotiating with the receiver, or its agents, after the collapse of Atlantic, one of the matters to be resolved was how much you ought to be responsible for in connection with the loans which the company made to you. Is that not correct?

A. I did not—

Q. One of the matters you discussed with the Clarkson Company after the collapse of Atlantic was the settlement of the accounts between yourself and various Nevil Companies arising out of loans which were recorded as having been made by those companies to you?

A. Yes.

Q. And \$40,000 of that money was loaned to you for the purpose of purchasing shares, as you say. Is that correct?

A. There was actually \$200,000 loaned.

Q. \$200,000 in all?

A. Yes.

Q. But this \$40,000 which was paid out to you by Nevil Plastics Incorporated is incorporated in that amount?

A. I imagine. Yes.

Q. Did it not strike you then that you would discuss with the trustee how that \$40,000 debt arose and point out to them who, in fact, had benefit from that?

⁵Evidence Volume 55, pp. 7505-6.

NEVIL GROUP

A. I had very, practically no discussion with the trustee except in the settlement of the company. I preferred not to get involved in discussion with them at that time. I went through eight months of trying to make a settlement, which was the prime object at that moment, and any other discussions were minor.

Q. Mr. Levinson, I am going to leave this point now, but is there any additional explanation or evidence you would like to give respecting that \$40,000, or have I asked you all the questions?

A. I have just told you the truth. I don't know anything else at the moment."

Later and at the conclusion of the evidence he professed to know more, and his counsel asked Mr. Shepherd to put additional questions to him.⁶

"Q. Did you tell your auditors that you had paid out \$40,000 to Annett Partners and you hadn't received any stock?

A. I imagine we did because it was in their records.

Q. You mean the memorandum was in their records?

A. Yes.

Q. Do you recall—

A. Actually any loan was put down in the memorandum so I would have some record.

Q. Do you recall what observations they made about that?

A. No.

Q. Did you tell anybody else other than Mr. Morgan about this arrangement between you and Mr. Morgan on the purchase of shares?

A. You mean that I bought stock in Atlantic and my wife?

Q. Well, let me put it that you paid money and you expected it to be delivered to you?

A. Miss Drew knew that I had bought stock in Atlantic.

Q. Exactly \$40,000 worth?

A. That's right. I could imagine I mentioned it to a dozen people, my lawyers and so forth.

THE COMMISSIONER: At one point in the evidence you gave in connection with the \$40,000 you said that you thought that you would hear about the result of that payment, either in the form of stock or some type of acknowledgement, upon the reduction of the loans. That was the phrase you used. You might explain that.

A. I assumed this money was being held for me. At least the stock was being held.

⁶Evidence Volume 55, pp. 7540-2.

Q. Yes, but did it depend upon the fact that you or your companies rather owed a lot of money to Mr. Morgan's company?

A. No.

Q. I just wanted to clear up that point because I got the impression that you were suggesting that this money was a sort of pledge?

A. No.

Q. Of repayment by your company?

A. I am sorry. What I was trying to suggest was that I couldn't very well press for this.

Q. You didn't feel you were in a strong position?

A. That's right. Exactly."

By this time the progress of Morgan's last illness had put him beyond the reach of further questioning and his explanation of this payment will never be known.

It was difficult at the time when this evidence was given to believe any part of it, other than the simple fact that, out of the funds advanced by Adelaide Acceptance to Nevil Plastics Inc. through Nevil Plastics Limited, Levinson had given \$40,000 back to Morgan and had not troubled to inquire further because he had never considered Morgan accountable. Upon reflection I am satisfied that Levinson was not telling the truth, and that the payment to Annett Partners Limited was an indirect means of putting \$40,000 into Morgan's hands, constituting one more example, and an unusually blatant one, of a personal benefit derived from the loans that he was able to make in his sole discretion as president of the lending company. In spite of the undertaking given to produce the cheque to Annett Partners Limited, it was never provided to the Commission.

Diminished Security for Atlantic Loans and Eventual Loss

By July 31, 1962 total loans from the Atlantic subsidiaries to the Nevil group of companies had increased to \$833,345.48, or by \$488,165. At the next year-end on July 31, 1963 the total had reached \$1,225,451.77, and this period was marked by the transfer of indebtedness in part from Nevil Plastics Limited and Nevil Plastics Inc. to Nevil Enterprises Inc., and a loan for the first time to Tools and Molds Inc. made by Commodore Factors on May 15, 1963 the principal amount of which was \$420,000 with deferred interest of \$150,000.¹ The whole amount of \$570,000 was to be repaid in five years by monthly payments of \$9,500. Another agreement of the same date was entered into between Tools and Molds Inc. and Nevil Enterprises Inc. by which the former acquired all

¹Exhibit 2510.

the moulds belonging to the latter.² Tools and Molds paid \$320,000 for this purchase, gave Commodore Factors a chattel mortgage for a loan of \$420,000 and leased the property back to Nevil Enterprises Inc. With the remaining \$100,000 borrowed from Commodore Factors, Tools and Molds made a loan to Nevil Enterprises which thus got the whole \$420,000; then it paid \$350,000 back to Commodore Factors on the following day in reduction of accounts receivable and notes receivable loans outstanding at that time. The effect of the transaction was to relieve, once again, the principal operating company from the burden of a debt of \$350,000, which was simply transferred with the additional \$70,000 to the new company. This concession was more than matched by Adelaide Acceptance, which, after July 31, 1963, by journal entry eliminated from its books the loans due to it from Nevil Enterprises and transferred them into the name of Nevil Plastics Limited, the completely dormant member of the group, having as its only assets loans receivable from other members. Atlantic money continued to be poured out thereafter, and by July 31, 1964 the loans had increased by \$485,914 to \$1,711,366. During this period, and on March 31, 1964, Commodore Factors by journal entry reduced by \$100,000 the amount of the loans secured by accounts receivable, setting this up as an unsecured notes receivable loan, although retaining the assignment of all the accounts receivable formerly pledged. This produced a discrepancy between the full amount shown on the Commodore Factors sub-ledgers and the control account in the general ledger, and should be noted because of subsequent comment which must be made on the validity of Commodore Factors accounts receivable in the final stages. A further increase in loans during the year ended July 31, 1965 raised the total outstanding to \$2,031,653, which is not significantly different from the amount owing on June 15, the date of the Atlantic collapse.

By an agreement made on December 28, 1965 between Neville Levinson and the Clarkson Company Limited, loans, which at that time amounted to a total of \$2,090,622 in American funds after converting Canadian funds at a discount of 8%, were reduced to \$300,000 repayable without interest, secured by a mortgage on the fixed assets of the companies and by Neville Levinson's personal guarantee. The balance of the amount due was forgiven and written back to surplus in the accounts prepared for February 28, 1966 by Riddell, Stead, Graham & Hutchison. In the event of the payments prescribed under the agreement not being made on the due dates the whole amount of original debt was to become at once due and payable with interest at 10%, calculated from December 15, 1965. The immediate effect of this was that a loss to Atlantic Acceptance of \$1,790,622 in American funds was accepted, and would have

²Exhibit 2511.

been thus determined had the \$300,000 been paid. The Commission has been advised, however, that default occurred on June 30, 1967, and a petition in bankruptcy was filed in the State of New York on August 24 of that year. While the amount of any recovery under the new proceedings cannot yet be determined, it is unlikely to exceed to any great extent the \$76,000 recovered before default under the agreement of December 28, 1965, and the loss to Atlantic Acceptance must be held to be correspondingly increased.

Woolfrey's Warning to Morgan: The Re-financing Proposal

This account may be concluded by an observation on what proved to be the central difficulty in the relationship between the Atlantic subsidiaries and Neville Levinson's companies with their voracious appetite for money. According to Woolfrey's evidence, financial statements of borrowing companies were not within his area of responsibility and were secured, if at all, by C. P. Morgan himself. Woolfrey had never seen one of any of the Nevil group, and he said that all correspondence between Levinson and the executive offices was delivered unopened to Morgan's desk and only transmitted to himself when money was required, which was almost invariably the case. Woolfrey was not concerned with the affairs of Adelaide Acceptance, but he and his small staff from time to time did field audits of the books of borrowers from Commodore Sales Acceptance and Commodore Factors. On only two or three occasions was he asked by Morgan to go to Buffalo to attempt to confirm the accounts receivable records of the Nevil companies, and these visits were generally abortive because of the infrequent appearances of Levinson, and the fact that his book-keeper maintained that he had no adequate records to keep the books in a current condition, some of these being in New York and not in the Buffalo office. Woolfrey came early to the conclusion that the books in Buffalo were not properly or currently posted and reported to Morgan in these terms. Morgan said he would try to get the figures from Levinson, and Woolfrey suggested that further field audits, which always produced friction, might well be discontinued and the responsibility left to Kane of Riddell, Stead, Graham & Hutchison. It was the practice to send every borrower a confirmation of accounts receivable pledged monthly, and request their comments if these did not happen to coincide with their own records. No reply was ever received to these letters from any of the Nevil group in the normal course of their borrowing over several years, with two exceptions as will be seen hereafter.

Eventually, and after repeated requests by Morgan, whose patience with Levinson amazed Woolfrey, a list was prepared by Nevil Enterprises of accounts receivable as at August 31, 1964 and given to Woolfrey,¹

¹Exhibit 2515.

showing "actual receivables" of \$257,748.64 and what were described by Levinson as "deferred receivables" of \$437,374.75. Woolfrey went over the list of deferred receivables with Levinson and made a pencilled note to the effect that there was "no problem" in collecting amounts shown as deferred, as far as Levinson was concerned. At the date of this list Commodore Factors recorded that it held assigned and outstanding accounts receivable from Nevil Enterprises in excess of \$700,000. Among the deferred receivables was an amount of \$120,000 shown as owing by E. R. Squibb & Sons. Levinson's explanation was that a number of the larger purchasers placed orders with instructions to ship as notified at a later date, the order being prepared ahead of time and held in stock or in a special warehouse. Some of these had been pledged to Commodore Factors for upwards of two years, and Woolfrey said that this caused him to make a special list of the oldest and largest and send it to Levinson for confirmation, after submitting it to Morgan for his information. No reply was forthcoming. Finally, in September of 1964, Morgan told Woolfrey to arrange with the auditors of Nevil Enterprises, Commodore Factors' lawyer in New York, Benjamin H. Oremland, and the Nevil companies' New York attorneys the re-financing of the Nevil Enterprises and Tools and Molds loans on a long-term basis. These negotiations dragged on until February of 1965, and at length foundered on the difficulty of providing Commodore Factors with instruments of security as required under the Uniform Commercial Code which, among other things, provided for an assurance of the solvency of the borrowing companies. Woolfrey received a letter from Oremland dated December 7, 1964, signed by his associate Morton R. Ruden,² referring to his negotiations with the attorneys for Nevil Enterprises, and saying:

"Paul Sawyer has advised me that one, and possibly both of the above companies are insolvent. Analysis should be made of current financial statements of each company to determine whether such is in fact the case, and if so, the extent of the insolvency. In the event the companies are insolvent in a bankruptcy sense, the granting of a security interest in assets owned by the company may be set aside as a voidable preference."

This opinion, given by a professional adviser on the other side of the table, was conveyed by Woolfrey to Morgan, but he continued to advance funds at an accelerated rate in 1965.

Eventually Woolfrey himself took a hand in attempting to solve the problem of re-financing in a memorandum entitled "Proposal to Re-Finance Debt of Nevil Enterprises Inc. and Tools & Molds Inc."³ This was addressed to "Mr. C. P. Morgan" from "A. G. Woolfrey", and would appear to have been submitted in March of 1965 from a handwritten

²Exhibit 2516.

³Exhibit 2513.

note by Levinson, acknowledged by him to be his, reading "O.K.—N. Levinson 3/21/65". The gist of the proposal was that all the debt of the Nevil group would be re-organized by Adelaide Acceptance taking the instalment loans, and Commodore Factors the accounts receivable and inventory loans. The loan by Adelaide, which Woolfrey made no secret of wishing no longer to have under his supervision, was to be for a five-year term with the monthly payments amortized over fifteen years, with "add on" interest at 6%, yielding an effective rate of 12% per annum. The significant portion of this document is a schedule attached to it containing a statement of account for Nevil Enterprises and Tools and Molds with Commodore Factors and Adelaide Acceptance as at February 28, 1965. The grand total of loans outstanding is shown as \$1,939,912.56. This includes amounts due "to Commodore Factors Limited—U.S. accounts receivable assigned \$634,118.51", or a net amount of \$569,833.02 after deduction of dealers' reserve. Commodore Factors, according to its own ledgers, summarized in the list of accounts receivable outstanding at February 28, 1965 already referred to as giving details of the aging of the individual accounts,⁴ held receivables at that date in the total amount of \$734,756.01. The discrepancy of approximately \$100,000 is explained, as already mentioned, by the transfer of that amount to the notes receivable loan account and the retention of the corresponding assigned receivables. The re-financing proposal submitted by Woolfrey refers to an amount called "actual accounts receivable" of \$39,261.21. This figure is derived from another document found among the records of Commodore Factors, headed "Nevil Enterprises Inc. Accounts Receivable as at March 2, 1965", also endorsed "N. Levinson 3/2/65".⁵ Woolfrey said that this list was supplied by Levinson to Morgan and passed down to Woolfrey, apparently without comment, at least as far as he could recall.

The Assigned Receivables Discrepancy

Unless there was a private agreement between Morgan and Levinson permitting the latter to assign orders rather than the accounts receivable it is not probable that this was being done, or that the goods were being manufactured and held in inventory as completed awaiting instructions for shipment, which is the substance of Levinson's explanation of the accounts receivable discrepancies. In the first place, such an explanation is contrary to the express terms of the representations made and signed by Levinson on the assignment documents, although here it should be said that Levinson maintained in his evidence that he had not read the printed parts of the forms. In the second place, there is a list, also dated February

⁴Exhibit 2502.

⁵Exhibit 2514.

28, 1965, which is a schedule of inventory, also bearing the handwritten endorsement "O.K. N. Levinson 3/2/65", showing the total value as \$287,202.92, and the third page of Woolfrey's re-financing proposal showed that Commodore Factors already had outstanding \$272,052 described as loans on inventory. The possibility that Commodore Factors might have credited payments received from customers of Nevil Enterprises, not against accounts receivable but against some other loan, and retained the assigned receivables corresponding to the payments as still pledged, is disproved by examination of its cash receipts journals, which were carefully analysed and showed that in all cases payments received and forwarded by Nevil Enterprises were credited to the accounts receivable loans. It is true that in some cases a customer might remit a cheque paying two invoices which it had received, only one of which was factored and the other applied in reduction of another loan; these were usually in payment of freight charges and amounted to some \$200 in all.

Particular notice was taken of the three largest accounts on the list dated February 28, 1965,¹ which were those due from Hiram Walker Incorporated, the Nestlé Company and E. R. Squibb & Sons. At that date Commodore Factors showed as still owing on accounts receivable from Hiram Walker \$94,170.07, and from the Nestlé Company accounts receivable assigned to it, and still unpaid, were recorded as amounting to \$230,720.61; the E. R. Squibb & Sons assigned receivables stood at \$222,656.43. All of the assignment forms in respect of accounts receivable from these three companies in the possession of Commodore Factors were produced and entered in evidence,² and these included all those on which Commodore Factors had advanced money to Nevil Enterprises, and some half-dozen representing invoices for approximately \$75,000 against which no advance had been made; in short all of the assignment forms in the possession of Commodore Factors at February 28, 1965. It has already been seen that, out of the total of \$734,756.01 which they represent, the amount listed under "Special Dating", or as overdue for more than ninety days, was \$611,001.61. The total shown as current was only \$17,696; the current figure for Hiram Walker was \$1,203.32 as compared with \$92,932.68 shown as over ninety days overdue; for the Nestlé Company, out of a total of \$230,720.61 none are shown as current, and as much as \$179,389.65 as over ninety days overdue; for E. R. Squibb & Sons, out of a total of \$222,656.43, the amount shown as over ninety days overdue was \$160,335.17. If these accounts receivable actually existed, and were unpaid for a period of more than ninety days, it would be a most uncommon occurrence in the affairs of companies of their status.

¹Exhibit 2502.

²Exhibits 2498 and 2518.

At the time when this evidence was given to the Commission no document had been found confirming to the Nestlé Company the amount of money it owed to Nevil Enterprises or any of its satellites, but there was placed in evidence a carbon copy of a letter dated September 27, 1965 from the Buffalo law firm of Williams, Stevens & McCarville, acting for the Montreal Trust Company, and addressed to Hiram Walker Inc.,³ asking for a report on what the Hiram Walker records showed as payable; attached to it was a letter in reply from the Hiram Walker company dated October 19, 1965.⁴ The reply enclosed a copy of a letter received from Nevil Enterprises dated October 18 and apparently forwarded on the day of receipt. This letter was signed by "Miss P. Drew, D. Litt." and itemized invoices payable by Hiram Walker Inc. for \$617.88, and by James Barclay & Company Limited for \$52.44. These balances are consistent with the payments shown as having been made in the records of Commodore Factors by Nevil Enterprises after March 2, 1965 and up until October, 1965, on the assumption that the outstanding accounts receivable from Hiram Walker were correctly shown as \$5,257.29 on the list of "actual receivables" at March 2, 1965, furnished and signed by Neville Levinson.⁵ The list of accounts receivable given in the letter from Williams, Stevens & McCarville to Hiram Walker was analysed by Mr. Scott, and it would appear that approximately \$67,000 was advanced in respect of them to Nevil Enterprises, and \$7,800 applied to the reduction of other indebtedness of that company; so that the total benefit received by it from Commodore Factors arising out of the pledge of receivables listed was approximately \$74,800. Each of the assignment forms examined had one or more invoices attached to it, each of which contained a space for the entry of the number of the specific order made by the customer relating to the invoice; but these numbers appear in comparatively few cases, many of the spaces being left blank and others being marked "TEL", which evidently referred to orders given by telephone. Six assignments against which no advances were made by Commodore Factors were not overlooked in this analysis, and since the amounts of their attached invoices were all entered in the sub-ledgers for each customer's account, the effect was simply to increase the ostensible security for the sums which Commodore Factors had actually advanced.

Levinson's list of "actual receivables" at March 2, 1965⁶ attributes to the Nestlé Company \$9,150 and to E. R. Squibb & Sons \$484.95. These should be compared with the amounts shown by Commodore Factors as outstanding and unpaid on February 28, just three days before, for the Nestlé Company in the amount of \$230,720.61 and for E. R. Squibb &

³Exhibit 2519.

⁴Exhibit 2520.

⁵Exhibit 2514.

⁶Exhibit 2514.

Sons in the amount of \$222,656.43.⁷ Taking the analysis a step further, the total of all invoices to the Nestlé Company factored with Commodore Factors by Nevil Enterprises from beginning to end, including not only outstanding accounts receivable at February 28, 1965 but also those previously pledged and paid, amounted to \$341,010.36. The total receipts of Commodore Factors in respect of these amounted to \$94,239.75, leaving, according to the records of Commodore Factors, the sum of \$246,770.61 still owing. Over the same period the total of invoices factored in respect of E. R. Squibb & Sons was \$454,791.51 of which Commodore Factors was paid \$229,489.98, leaving outstanding \$225,301.53. In the case of Hiram Walker the total of invoices assigned by Nevil Enterprises was \$149,754.58; payment of \$51,873.40 was received by Commodore Factors and the balance of \$97,881.18 remained unpaid.

In fairness to Neville Levinson, the evidence which he gave to the Commission after considerable reflection and after reading transcripts of the evidence of Messrs. Scott and Woolfrey and the exhibits entered in connection with it, must be quoted in appropriate places. His explanation of the large personal loans made to him by his companies, and made, of course, with Atlantic funds, was given as follows under examination by Mr. Shepherd:⁸

“Q. The companies recorded loans to you, as you have said, something in excess of \$200,000. Is that correct?

A. Yes.

Q. How did these loans arise?

A. What was the purpose of them?

Q. Yes. What was the purpose of them?

A. For additional expenses, patent expenses, travelling expenses and various other money that was required to build up a business.

Q. Would this be travel expenses for travel which you did for the benefit of the company?

A. Yes.

Q. Why did you have that money recorded as a loan to you rather than recorded as an expense of the company?

A. I felt the expenses that were going through the company at the time were sufficient, and I did not want to build up an abnormal amount of expense in the company which would not be indicative of how our company would operate in the future.

Q. Surely it would be more indicative how the company was operating, or would operate in the future, if you charged expenses of the company to the company, wouldn't it?

⁷Exhibit 2502.

⁸Evidence Volume 55, pp. 7506-10.

A. Not then, in my opinion, because when you start a business and you don't have the volume, the business has not built up to the business you anticipate, it should anticipate at that time travelling and other expenses of that nature would be completely abnormal to the type of operation which we eventually hoped to achieve.

Q. How much did travelling expenses amount to in a year? Let us take any year, 1963?

A. Forty, fifty thousand dollars a year.

Q. And how much of that would be contributed by you to the company because you take the money out of the company, but you record it as a loan?

A. Possibly twenty, twenty to twenty-five.

Q. How was this travelling expense paid physically? What was done?

A. There are certain . . .

Q. You buy an airline ticket. How would you pay for it?

A. Cash.

Q. You would take the money out of the company in cash. Is that correct?

A. No. I would pay for it and put in expense sheets for the amount, certain amounts, into the company, hotel bills, travelling.

Q. Then, of course, your accountants would pick that up and charge it as travelling expense and accommodation?

A. That is true, but the actual amount of money required for travelling and expenses in the company would be put down as a loan to me. Anything that was additional was put down as a loan to me.

Q. Now, the evidence is generally to the effect that the accountants followed this practice: at the end of the year they would come into the company, examine the total disbursements to you, deduct your salary from that and anything remaining which they could not account for they would record as a loan by the company to you. Is that right?

A. That is correct.

Q. If there were documents showing you had spent the money on travel expenses, they would charge it to travel expenses?

A. No, they would not, because I handed in travel expenses for just a certain amount of money. The additional amount I spent on travel or patent expenses personally and so on was not recorded in the books of the company.

Q. Who owned the patents at the time you were spending the money?

A. I did.

Q. That, of course, would be a company expense?

A. No.

Q. But the travel expenses, you say that in addition to the sum of approximately \$35,000 recorded in the tax return for your travel expenses during the year 1963, in addition to that you spent substantially more money on travel expenses for the company, but you took the money out and treated it as a loan to you?

A. As a personal loan, that is true.

Q. Apart from this payment of \$40,000, was any other of the money which you borrowed from the company used for the purpose of purchasing securities?

A. No.

Q. Was there any evidence of this debt such as a promissory note given to the company?

A. You mean for my personal loans?

Q. Yes.

A. No. It just showed in the records of the company.

Q. The records made by the accountant at the end of the year?

A. Or during the year. In the books of the company all this information was shown."

Another document found in the files of accountants of Nevil Enterprises, entitled "Nevil Enterprises Inc.—Sales by Customer from 1958-1965", gives some figures in relation to the larger accounts extending over this period, which of course antedated the incorporation of Nevil Enterprises in November, 1961.⁹ For both the Nestlé Company and E. R. Squibb & Sons the first sales recorded are in 1963, and are shown as late as June 30, 1965. The figures for Hiram Walker begin in 1959 and continue to the same date. For purposes of comparison, figures have been selected from this document showing total sales to the three companies for the two full years 1963 and 1964, and for the half year in 1965, giving the following results:

"Nestlé	\$177,530
Squibb	213,811
Hiram Walker	78,158"

They are in every case lower than the accounts receivable shown as outstanding on February 28, 1965, when Commodore Factors' list of accounts receivable, pledged and unpaid, was sent to Nevil Enterprises for confirmation,¹⁰ the amounts being:

"Nestlé	\$230,720.61
Squibb	222,656.43
Hiram Walker	94,170.07"

⁹Exhibit 2486.1.

¹⁰Exhibit 2502.

The comparison is completed by the Nevil Enterprises' list of accounts receivable at March 2, 1965,¹¹ referred to in Woolfrey's re-financing proposal to Morgan¹² as "actual accounts receivable", totalling \$39,261.21 in which Nestlé is shown as owing \$9,150, Squibb \$484.95, and Hiram Walker and James Barclay & Co. shown as owing between them \$5,294.62. These documents were put to Levinson.¹³

"Q. Evidence has been given that the receivables recorded on this exhibit 2502 are in conformity with the amount of receivables being carried on Commodore Factors' books as outstanding. Having read the transcript, I suppose you are aware that evidence has been given?

A. I read the transcript, yes.

Q. Now, may the witness be shown Exhibit 2514. That exhibit is headed Nevil Enterprises Incorporated, Accounts Receivable as at March 2nd, 1965, and there follows a typewritten list, and at the bottom appears in handwritten form 'O.K. N. Levinson 3/2/65'. Is that your signature?

A. Yes, it is.

Q. Yes. I draw your attention to the fact the Commodore Factors book, recorded that they had outstanding as unpaid on the 28th February, 1965, receivables in the amount of \$734,756.01, and the list of accounts receivable as at March 2nd, 1965, signed by you, totalled \$39,261.21. What is the explanation for the discrepancy?

A. I don't know. I did not look after Commodore books, but so far as we were concerned this was our receivables list.

Q. The receivables total was the \$39,000-odd?

A. Yes.

Q. Mr. Levinson, there was put into evidence a bundle, a very large bundle, of assignments of accounts receivable which are all the accounts receivable assigned in respect of three of these customers, Nestlé's, Swift (sic), and Hiram Walker, I believe, and those assignments of accounts receivable do add up to the amounts shown on Exhibit 2502. Would you agree at least Commodore Factors had assignments of accounts receivable for such a sum of money?

A. I don't know. We gave them an assignment list every year actually and the assignments were revised in accordance with our records, and some of the accounts, if we did not collect them, were converted into inventory, and the receivable list would be changed so far as Commodore and we are concerned, so I could not tell you what records we had or if they were ever not used. I don't know.

Q. Let's take one of the larger customers. Commodore Factors carry on their books as at 28th February, 1965, pledged receivables not yet

¹¹Exhibit 2514.

¹²Exhibit 2513.

¹³Evidence Volume 55, pp. 7518-28.

paid by Nevil Enterprises Inc. In respect of Nestlé of \$230,720.61. Do you see that amount? It is on the second page about a third of the way down.

A. Yes.

Q. What puzzles me is Exhibit 2486.1, which is the document first shown to you when dealing with this matter, a list of sales by customers from 1958 to 1965, shows that up to the 30th June, 1965, your total sales to Nestlé were \$177,530, which is substantially less than is shown on the books of Commodore Factors and supported by assignments as being still outstanding and unpaid. Can you explain this?

A. You are looking at a projection sheet, Mr. Shepherd, which was made up from the receipts in the company that we got from the company within that time, not the orders or business we had actually done with them.

Q. Mr. Levinson, it is your document and it is called Sales by Customers.

A. That's right. These are paid sales.

Q. What other kind of sales did you have?

A. Well, the ones we hadn't shipped yet and hadn't invoiced yet. This would show in the records of our company as being paid. That is why they are marked in this respect.

Q. Let me see. Do you now say that up to 28th February, 1965, there may well have been outstanding and unpaid orders by say—correction—receivables by say Nestlé in the order of \$230,000; is that correct?

A. Mr. Shepherd, since February 28th, 1965, we have received from Nestlé's cheques in the amount of \$159,755.38.

Q. Since what date?

A. Since February 28th until April of this year.

Q. How much did you receive up to the end of June? Do you have that figure?

A. To the end of June we received about \$23,000 roughly.

Q. About \$23,000 up to the end of June?

A. Yes.

Q. Of 1965?

A. Yes.

Q. Did you remit all that money to Commodore Factors?

A. Yes, everything was remitted to Commodore Factors.

Q. Can you explain, Mr. Levinson, in a few words how it is that Commodore Factors have assigned with them outstanding receivables of \$230,000 from Nestlé and you record three days later that the amount of money outstanding on that particular account is \$9,150?

A. Because actually this list that we had given them was the actual list of merchandise shipped, not merchandise that was going to be shipped. This list was made up for a refinancing agreement, which, I believe, you have in your exhibits, which was discussed in New York between Commodore, Woolfrey, their lawyer, our lawyer, and our accountant. And it was agreed that all receivables in the future would be listed as only the merchandise actually shipped at that time, and the other merchandise not shipped would be put into inventory and it would be a financing agreement on inventory.

That was the actual discussion which I believe you have in your exhibits.

Q. Do I understand you to say then that there was outstanding on the 28th of February, 1965, with Nevil Enterprises Inc. from the Nestlé Company either actual receivables of goods completed and shipped or firm orders in the sum of approximately \$230,000; is that correct?

A. No, I didn't say that.

Q. If you didn't say that, Mr. Levinson, I think perhaps you have not yet explained the discrepancy between those two amounts.

A. Well, you are discussing, Mr. Shepherd, their records, not our records. I don't know what was in Commodore's records actually. As a matter of fact, this sheet, I have never seen it except the last time you showed it to me. So I really don't know where the discrepancy is."

It should be noted with regard to this explanation, if such it can be called, that no re-financing agreement was ever implemented, and that whatever may have been done, in the single instance referred to, by way of transferring part of the indebtedness in the amount of some \$100,000 to the notes receivable account of Commodore Factors, assignments of accounts receivable remained as originally posted and all were supported by invoices sent from Buffalo. The examination continued as follows:¹⁴

"THE COMMISSIONER: Let's assume then for a moment, Mr. Levinson, that Commodore's records were based upon your assignments. What would be the explanation, assuming that to be the case?

A. I don't know. Maybe they have one. I don't know.

MR. SHEPHERD: May the witness be shown Exhibit 2498 again, please.

Q. You said, Mr. Levinson, that at about the time this list of actual accounts receivable, on the 2nd of March, 1965, was made up, it was agreed that you would show only goods actually shipped. And did you?

A. Yes.

Q. Was that the first time that that agreement had been made? Were you changing the practice which you had followed?

A. Changing the practice, yes, actually.

¹⁴Evidence Volume 55, pp. 7528-30.

Q. With whom did you have that discussion?

A. Mr. Woolfrey, their lawyer, our lawyer and our accountant in New York at our lawyer's office.

Q. You see, you had been making that agreement, I think, from the very beginning?

A. I am sorry, Mr. Shepherd. This agreement was made prior to that. I believe it was four or five months prior to the other agreement that was drawn up at that time. I think you have an agreement that was drawn up, when was it, February 28th, around that time.

Q. Exhibit 2498, Mr. Levinson, on the second page, which is the assignment form which you executed in every instance, says among other things in the second paragraph:

'The Assignor'

And that is your company:

' . . . warrants that the merchandise represented thereby has been delivered to and accepted by the company therein named.'

Was that true?

A. I really haven't read the print before. It does say that. I actually didn't know that.

Q. The statement is not true, is it?

A. Pardon?

Q. The statement is not true in respect of these assignments?

A. No, according to this, apparently.

Q. Did Mr. Morgan know that you were assigning orders as opposed to assigning receivables?

A. Yes, he knew. Mr. Woolfrey knew. They all knew, anybody we dealt with."

Whatever Morgan may have known about this has not been recorded and, although Levinson's concluding observation is to some extent supported by the inclusion of his "actual accounts receivable" figure in Woolfrey's re-financing proposal made to Morgan in March, there is no evidence which I can accept that Woolfrey knew that Levinson was not assigning valid accounts receivable until he received the Nevil Enterprises list of March 2, the result of which was then incorporated in his memorandum. To be sure, he knew from September 1964 onward that, of upwards of \$680,000 worth of Nevil Enterprises' accounts receivable at August 31, over \$437,000 worth were classified by Levinson as "deferred", but he had been assured that there was no problem about collecting these.¹⁵ It would, however, be idle to suggest that both Morgan and Woolfrey did not know, at least from September 1964 onward, that the situation of the Nevil companies was desperate, and this was confirmed by them by

¹⁵Exhibit 2515.

the letter from Oremland's office received in December of that year. Since, according to J. C. Laidlaw, Levinson and Miss Drew were to be found at the Morgans' house in Toronto sufficiently frequently to be distasteful, it is entirely probable that Morgan knew more than he conveyed to Woolfrey.

Levinson's Explanation

A reference must be made to Neville Levinson's main argument offered in explanation of the huge discrepancy between the accounts receivable assigned and the amounts which appeared to be actually owing from his customers. It was repeated more than once, and the following excerpt is characteristic:¹

"Q. Now, when you wished to borrow money secured by accounts receivable, you would execute an assignment form and attach the invoice of the order and send to Commodore Factors. Is that correct?

A. Yes.

Q. And did you assign to them all of your receivables?

A. Yes.

Q. With whom did you deal in making this arrangement?

A. Through Mr. Morgan and Mr. Woolfrey.

Q. In each case when you assigned an account receivable and attached an invoice, had the goods been completed and delivered?

A. Not necessarily.

Q. What would happen when they were not completed and delivered? How was that handled?

A. It is quite normal process in our business to invoice ahead of time, such as an advertising agency and so forth, as we usually have a substantial investment in tooling and raw materials and so forth, and some of our clients can leave their merchandise for six months until they give us releases over all parts of the country, Alaska and so forth, and Hawaii, and we can hold the merchandise and not invoice for it, and normally we would invoice ahead of time.

Q. Mr. Levinson, I quite readily see where the goods had been manufactured and were ready for delivery, but the customer did not want them, clearly the customer owed you the money for them, but would you sometimes pledge as accounts receivable orders in respect of which the goods had not been manufactured?

A. Oh, yes.

Q. Did Mr. Morgan know that you were doing that?

A. Yes, he did.

¹Evidence Volume 55, pp. 7512-6.

Q. Let us take a specific example. You received an order from someone. How would you receive an order?

A. Sometimes verbally, sometimes in writing.

Q. Would you have in nearly every case either a written order or a written confirmation?

A. No.

Q. Tell me how these orders were pledged which were placed verbally?

A. Over the telephone or at a meeting during discussion of what amount of a certain product would be used over a certain time.

Q. And there would not be subsequently a written confirmation lodged with you?

A. Sometimes three months after we shipped the order.

Q. Sometimes never?

A. Sometimes never. We never had an order from Loblaw's for \$2,000,-000 worth of merchandise, and still don't get orders from them.

Q. Just on the telephone?

A. Yes, or a meeting.

Q. Do I understand you to say that your customers, some of whom were very large companies, followed the practice of ordering goods orally on the telephone and not confirming the order immediately in writing?

A. That is true.

Q. Is that true of Hiram Walker's, Nestlé's, Swift's? (sic for Squibb)

A. Yes. I might help you on that, Mr. Shepherd. We deal with a special part of a company. We don't deal with the normal part of a company. It is always the merchandise end or marketing end of the company, and the amount they spend is normally put into budgets, as for advertising for that year, or promotion that year, and sometimes they can't place the order if a budget is used up and they want merchandise, but want it put into the next budget. These are the problems that arise, and actually to physically get some of the orders through these companies for this particular type of merchandise can take two or three months sometimes.

Q. Now, the conversations you were describing as orders, do I understand that these are firm, clear orders in which quantities, prices, delivery time and the other relevant factors are determined and agreed on? They are orders?

A. Yes.

Q. Firm. Is that correct?

A. You mean over the telephone?

Q. Yes.

A. Yes, we consider them firm.

Q. Does it not strike you as unusual that a purchasing agent of one of these large companies would be permitted to pledge the company and submit it to substantial orders orally and not confirm it?

A. No, it does not strike me as funny as this is the manner of their business.

Q. So some of the receivables that you pledged then relate to oral orders, some of them relate to written orders. Is that correct?

A. True.

Q. Mr. Levinson, would you normally pledge this order as being a receivable as soon as you got the order?

A. Not normally. Just prior to the order maybe if we required a certain amount of money we would pledge it at that time."

At the time when this evidence was given the Commission's investigations were still incomplete, and gradually merged into a large investigation out of which criminal charges against Levinson have arisen. No witnesses were called, or invited to attend, from the many customers of the Nevil companies to give their version of the practice which prevailed in making and recording substantial orders for goods, because the people involved were not identified by Levinson, and were in any event resident in the United States where they could not be compelled to appear before the Commission. The assistance of the Securities and Exchange Commission was sought to circularize customers of Nevil Enterprises, a course of action which naturally caused Levinson considerable alarm and inconvenience and led to protest by his counsel; at the same time parallel inquiries were being made by the Montreal Trust Company on behalf of Atlantic Acceptance which increased his discomfort. It will not be considered surprising that the employees concerned with the purchase of goods from Nevil Enterprises on behalf of their companies have repudiated Levinson's account of their business relationships with him, but it is by no means certain and cannot be safely accepted that the iron-clad systems of control which they claim to have followed were not, in certain instances, breached. The final testing of their evidence and of Levinson's must be left to the courts; it can only be said that the methods of business described by Levinson in his answer to questions put by Mr. Shepherd, and later in the proceedings by me, are so bizarre as to appear improbable.

The Commission's Evidence Unanswered

A final word should be said about the strong indignation of Mr. Karfilis over the evidence of his client's dealings offered to the Commission, expressed at the conclusion of Levinson's evidence on July 15, 1966, after, be it said, Mr. Shepherd had put additional questions in clarification to him as counsel requested. Mr. Karfilis wished to make a statement

upon some of it which he deemed to be unfair to his client, and I advised him that, at the conclusion of all the evidence called by counsel for the Commission, time would be provided for the hearing of evidence from and on behalf of persons who considered themselves to have been adversely affected, or wished to supplement the record. The conclusion of this exchange and its sequel should be quoted in fairness to all concerned.¹

“MR. KARFILIS: It is not my intention, my lord, to make any statements, as I understand it. Referring specifically, if I may, with your permission, my lord, if I may refer you to page 6702 of the transcript of Mr. Woolfrey’s evidence, the question was asked of Mr. Woolfrey whether or not he had seen an actual account of the amounts receivable. His answer was, no, that he had not. It is a fact, my lord, that the statement of \$39,000 was found in the Commodore books.

Regarding the negotiated deal of refinancing, my lord, a letter was sent by Mr. Sawyer. It is in your files. It is by Mr. Oremland who acted for Atlantic Acceptance when they were refinancing, when they were proposing to refinance at that time. Mr. Sawyer, who acted for Mr. Levinson, disclosed to the company in detail how much was outstanding, the exact amount of the outstanding amount.

THE COMMISSIONER: Who says so?

MR. KARFILIS: According to your exhibits, the exhibits which you have accepted.

THE COMMISSIONER: Are you now urging upon me what findings I have to make on the evidence?

MR. KARFILIS: No, my lord.

THE COMMISSIONER: Because if you are I say the time has not yet come.

MR. KARFILIS: No, I am not doing that, my lord. The only thing I am trying to do is to present the facts for you in their proper perspective to enable you to come to, I think, what I think is the only conclusion to come to, my lord. You cannot reach a decision without seeing—for example, I had intended to explain to you this great business of—

THE COMMISSIONER: I am not making any decisions at this time, Mr. Karfilis, I assure you.

MR. KARFILIS: Well, my lord, it is not fair. You cannot, I urge, make a decision on this—you have heard evidence today of money being loaned to Mr. Levinson, \$200,000, and that is an extreme figure. We have an explanation.

THE COMMISSIONER: I must have explained to you before that the evidence I am interested in is the evidence being given today by Mr. Levinson. Now, I am not asking you to give evidence either on oath

¹Evidence Volume 55, pp. 7550-6.

or otherwise. It is conceivable that you can submit yourself as a witness at some later time but that does not happen to be our plan at present.

In due course I will have to consider all the evidence that has been given and the fact that it has been given on oath, and I confidently expect to find some disagreement between witnesses. It would be a very unusual proceeding if all the witnesses agreed with each other. I am also confident that many of these disagreements will be honest disagreements. But it is for me to say what evidence I believe and what I do not believe.

Now, at the proper time you will be given an opportunity to address argument to the Commission in the normal course. I can only tell you that the time has not yet come.

MR. KARFILIS: Mr. Commissioner, I have not made myself clear. It is not argument that I want to present to you. It is not testimony that I wish to present to you at all. It is evidence that Mr. Levinson is prepared to give now to clarify some of the matters that have come before you. It is simply that, my lord.

THE COMMISSIONER: Well then, I suggest you ask counsel for the Commission to put supplementary questions to Mr. Levinson, as is the customary procedure, and, as I believe, you very well know it to be the custom.

This seems to be a very good time for an adjournment. It is past the usual hour. So we will take fifteen minutes and reconvene and if there are further questions which Mr. Shepherd can put I am sure he will be glad to put them and I will be glad to hear them.

—A short recess.

MR. SHEPHERD: Mr. Levinson, do you have anything further that you wish to say by way of explanation or fuller explanation or comment upon any of the matters that we have touched upon or, indeed, upon any matters concerning which evidence was given?

A. The only thing I have to say, Mr. Shepherd, is on the last agreement which I signed, of course.

Q. Which agreement is that, Mr. Levinson?

A. That was the one on the refinancing agreement.

Q. Oh, yes.

A. At that time that we got this agreement to keep the company alive we were prepared to sign pretty near anything to get the refinancing agreement signed. So, I actually didn't go into all details of it, it was signed hurriedly. And at that time we were just pressed to the point we had to keep our company going. I didn't go into all details of it.

Q. Is there anything you wish to comment upon?

A. No, sir.

MR. SHEPHERD: I have nothing further to put to Mr. Levinson.

MR. KARFILIS: May I point out two situations. First of all, the letter I wrote to this Commission with a cheque of \$9.90 re payment of the exhibits that were sent to me. On that letter it said, "Re Equity Explorations—Neville Levinson". That was an error in our office. I am a director of Equity and we are having our annual meeting this afternoon. I signed that letter and I did not notice at the top it said "Equity".

THE COMMISSIONER: Very well, Mr. Karfilis.

MR. KARFILIS: The other point, I accept the Commission's decision, gratefully, as a matter of fact, that we will be given an opportunity when it is convenient for this Commission to call evidence that might explain some of the things that have already been presented to this Commission.

THE COMMISSIONER: Yes. I envisage this at some time when Commission Counsel has called all the evidence he wants to call in connection with this inquiry, and then an invitation will be given for any other explanations.

MR. KARFILIS: Thank you very much, my lord, I accept that. Thank you very much."

When the time came to redeem this pledge, nine months later, Neville Levinson did not appear, and no representations were offered on his behalf.

A Plethora of Loans

Some features of this account of the lending of Atlantic money to the Nevil group of companies require a brief and final comment. Levinson spoke with feeling about the amount of interest included in the more than \$2,000,000 owed by them at the end, which he asserted amounted to \$900,000. It was pointed out to him by counsel that this included unpaid interest capitalized by the lender and added to the principal amount, which had not apparently occurred to him, but there can be no doubt that the experience of borrowers and lenders alike was a sad commentary on C. P. Morgan's conception of the rôle of the "secondary banker." The Nevil companies were literally choked by the loans made to them, and the cash generated by their sales was insufficient to sustain the salaries of Levinson and Miss Drew, the travelling expenses of the former, and the interest expense of the loans made to them, of which Levinson in turn borrowed better than 10% without making any repayment. Levinson said that he had a "very strong company" and that Morgan had great faith in it. If he had, it did not persuade him to make any personal investment, because, although he was an officer and director of three of the Nevil companies, he owned no shares, in contrast to his usual practice of taking a personal position in the companies to which Atlantic money was

loaned. Morgan simply took \$40,000 in cash and may well, like Lord Clive, have been astounded by his own moderation in the face of Levinson's superior rapacity. But the profusion with which the funds of Atlantic Acceptance were lavished on companies with no capital investment and steadily mounting deficits, maintaining their principals in luxurious office accommodation in the Statler-Hilton Hotel in Buffalo and the Savoy-Hilton Hotel in New York, and wallowing in a state of insolvency from which no recovery could conceivably be made or was ever expected, provides one of the darkest chapters in this once-imposing finance company's tragic and twisted story.

CHAPTER XIII

Valley Farm and Enterprises Limited

Indebtedness of William George Blacklock

The name of Valley Farm and Enterprises Limited has appeared previously in this report, chiefly in connection with loans, borrowings and share transactions which illustrate only part of its activities from the date of its incorporation as a private company in Ontario on August 4, 1961 to the date of its bankruptcy on August 11, 1965. It also operated a farm of some 825 acres, not wholly contiguous, in the Township of South Plantagenet in the County of Prescott, roughly half way between Ottawa and Cornwall. This activity continued from shortly after the date of incorporation until November 1963 and was conspicuously unsuccessful. In its farming operations and for its loans and investments it was entirely dependent upon Atlantic Acceptance Corporation which supplied it with funds through Aurora Leasing Corporation and Adelaide Acceptance by way of loans, and through Commodore Sales Acceptance with money secured by mortgage. In addition, Atlantic Acceptance embarked on a scheme to finance the purchase of cattle throughout Ontario, planning to use Valley Farm and Enterprises for recourse on conditional sales contracts assigned to Atlantic by vendors and as a repository for repossessed animals. For performing this function Valley Farm and Enterprises was paid, at regular intervals, sums set aside by Atlantic as "dealer reserve".

The reason for the creation of this company and generally the involvement of Atlantic Acceptance in the financing of cattle purchases, consistently given by C. P. Morgan, was the necessity of solving the financial problems of William George Blacklock. Blacklock's connection with Atlantic through Valley Music Company has already been noticed

in Chapter V, dealing with the affairs of Aurora Leasing Corporation.¹ The evidence before the Commission indicates that Blacklock's first dealing with Atlantic occurred about 1956 and in connection with his operation of Valley Music Company. Information received from David Davidson may justify the opinion that an even earlier connection was formed, arising from his business as an automobile dealer. Blacklock's activities were in fact multifarious in that period in the 1950's when Cornwall was the centre of the great St. Lawrence Seaway development, and much property and business was being relocated to allow for the flooding of the river valley. In addition to acquiring properties in Cornwall, one in Morrisburg and a number of farms, including those which were put together to form the Valley Farm, Blacklock had become indebted, particularly to the Canadian Imperial Bank of Commerce, for very large sums, estimated by C. P. Morgan in his examination for discovery in the bankruptcy of Valley Farm and Enterprises² as approximately \$1,000,000, of which better than \$600,000 was owed to the bank in question. In 1959 Blacklock's situation had become such that a concerted effort had to be made to consolidate or otherwise arrange his debts to Atlantic Acceptance, and the first step was taken by setting up a "Blacklock Leasing Company" account at the Oakville head office in which any payments made by Atlantic on his behalf showed as a debit and to which all receipts were credited.³ This device enabled the branch office accounts to be credited with payments made ostensibly by Valley Music Company and other Blacklock enterprises which, in fact, were advanced by Atlantic itself and debited to the Blacklock Leasing account. Blacklock, indeed, was responsible for the suggestion that Atlantic open a branch office in Kingston in 1959 under the direction of his brother Neil Blacklock, and promised it substantial automobile financing business in addition to the doubtful privilege of handling the Valley Music account; in fact, it was the withdrawal of Industrial Acceptance Corporation from the financing of electrical appliances and the lucky chance that Neil Blacklock, a former employee of that company, was a man of real ability, that made the Kingston branch prosperous. Later in 1961, as will be recounted, the affairs of George Blacklock led to the opening of another branch in Cornwall as a result of another suggestion by him and his associate Omer Poirier, a drover and owner of a cattle auction in Alexandria. It was at this point that Valley Farm and Enterprises appeared on the stage, but before proceeding with the narrative of its history a digression must be made to examine in more detail the situation of the Blacklock Leasing account.

¹pp. 152-6.

²Exhibit 3676.

³Exhibits 1367 and 1369.

Blacklock Leasing

Evidence on this subject was given to the Commission by both Mr. B. W. McLoughlin of Touche, Ross, Bailey & Smart and Mr. E. N. Elford, an internal accountant employed by Atlantic Acceptance Corporation.¹ An example of how the Blacklock Leasing account was employed is provided conveniently by the payments made on behalf of Valley Music Company in a total amount of \$19,000, consisting of five monthly payments of \$3,800 between April 30 and August 31, 1959. Loans made by Atlantic to Valley Music had reached the figure of \$135,266.71 by the end of 1958. On or about December 28 in that year they were consolidated, new service charges calculated, and a new account opened showing an outstanding balance of \$148,200 including service charges of \$12,933.29. Six payments of \$3,800 were in fact made, including the five already referred to, the first paid in January 1959 before the Blacklock Leasing account was set up. In October \$5,400 was written off reducing the balance to \$120,000, and it was then sold to Commodore Sales Acceptance for that amount and on terms previously referred to in Chapter V.² The five payments between April and August amounting to \$19,000 were made simply by journal entry, crediting the Valley Music account in Atlantic's branch office at Kingston and debiting the Blacklock Leasing account at Oakville. This internal bookkeeping by Atlantic was characteristic of the operation of the Blacklock Leasing account and produced the appearance of regular reduction of George Blacklock's various liabilities without requiring the payment of any cash by him. It will be recalled that in November 1960 Aurora Leasing Corporation was required to intervene in the process of liquidating, or perhaps concealing, the inconvenient and intractable liability of Valley Music, which it did by purchasing the latter's coin-operated machines for \$300,000 and leasing them back to the vendor, a transaction examined previously at some length.³ The purchase price was borrowed from Commodore Sales Acceptance and paid off, among others, that company's loan to Valley Music, so that, in conformity with the practice observed heretofore in so many instances, the money went round in a circle and merely substituted one debtor for another. Atlantic continued to supply funds for the operation of Valley Music Company until 1963 in which year the Blacklock Leasing account became virtually dormant. By the end of July, 1963, the excess of disbursements over receipts from Valley Music Company was debited to the Blacklock Leasing account in the total amount of \$22,448.11.

Generally speaking, and without describing all the entries in detail, this account reflected advances made by Atlantic Acceptance in respect

¹Evidence Volume 15.

²p. 152.

³Chapter V, pp. 153-6.

of various enterprises of George Blacklock, his dealings in used automobiles and his building enterprises which included two stores and two service stations, and payments made to reduce from time to time the indebtedness of Valley Music Company to Commodore Sales Acceptance and Aurora Leasing as occasion required. The account was charged with interest at 7%, calculated from the outstanding balance at each month-end, until November 1963 when instructions were apparently given not to charge any more; the accumulation of interest charges at that point amounted to \$31,329.26. Receipts which were credited to the account consisted principally of book-keeping entries arising from the opening of specific mortgage accounts in connection with indebtedness on building projects, and real estate loans secured by mortgage were transferred to individual mortgage accounts and credited to Blacklock Leasing. One credit was of a different order, representing a receipt of cash in the amount of \$150,000 on June 30, 1961 from Commodore Sales Acceptance, a loan which was secured by a third mortgage for \$220,000 on the properties eventually owned by Valley Farm and Enterprises, to include unearned interest on the amount advanced. Rentals received from the Blacklock buildings owned by his company, Blacam Realities Limited, including rent paid by Atlantic Acceptance for its first Cornwall office, were also credited to the account, and from June 1963 to August 1964 Valley Farm and Enterprises made a series of payments of \$2,500 approximately monthly, amounting in all to \$30,000 on Blacklock's behalf. By the end of 1964, after a period of quiescence since November 1963, disbursements from the Blacklock Leasing account exceeded receipts by \$51,606.03, an amount which was written off in September of 1964 by General Acceptance Corporation, the eventual purchaser of the acceptance finance and small loans business of Atlantic, and at the time operating the business under contract to its receiver and manager. Total disbursements, including the accrual of unpaid interest, made through the Blacklock Leasing account amounted to \$495,587.60 against receipts of \$443,981.57; but these receipts were bolstered, as has been said, by amounts credited to the account on transfer to specific mortgage accounts, the most considerable of which was \$175,000 represented by a mortgage given to Atlantic Acceptance to secure funds advanced for the building of an I.G.A. grocery store in Cornwall. This indebtedness was written off on December 13, 1965 in the amount of \$183,721.50, as was a capital loan to George Blacklock of \$118,857.04, so that the total write-off after the collapse of Atlantic amounted to \$354,184.57. The writing off of a debt secured by a mortgage of lands is unusual, and indicates either over-valuation of the mortgage property or undue subordination of the security. The mortgage in question was second to one dated October 1, 1957 for \$35,000 given to one Peter Bonnevillie as vendor, as part of a purchase price of \$75,000. The mortgage by George Blacklock

to Atlantic Acceptance was dated May 4, 1959 and the property was conveyed on December 15, 1959 by Blacklock to Blacam Realities Limited. Thereafter the premises were leased to M. Loeb Limited on March 2, 1960 for a yearly rental of \$17,574.

Blacam Realities was incorporated on September 8, 1959, according to Blacklock on C. P. Morgan's instructions, the directors being himself and his two brothers John and Neil. Two shares were owned by Neville Levinson who entered into an agreement to purchase the company's property on Brookdale Avenue in Cornwall, where he planned to build a plant for the manufacture of plastic products. This project did not materialize and Levinson forfeited the \$10,000 which he had paid as a deposit, and which George Blacklock testified to having put in his own pocket, ignoring the separate identities of himself and Blacam Realities. The company was used to hold title to all the Blacklock properties, and on June 13, 1961 all of the seven parcels of land which made up the Valley Farm were conveyed to it by him for a consideration of \$48,600.⁴ The purchase price was the sum of existing encumbrances on the property which consisted of a first mortgage to Traders Realty Limited securing, at the time of conveyance, \$38,600.02⁵ and a second to the Canadian Bank of Commerce which the mortgagee was agreeable to discharge in part for \$10,000 on August 16, 1961.⁶

The Farm

The seven parcels in the Township of South Plantagenet, amounting to 825 acres, had been acquired by George Blacklock in the year 1958, mostly from one Aurel Brunet, for a total consideration of \$12,801.88. Only three of them adjoined the main farm buildings which were situated about half-way between the hamlets of Riceville and Lemieux, in a sandy belt lying south of the South Nation River. All of them were in areas described on the Department of Agriculture's soil map for the County of Prescott¹ as "poor crop land". According to H. W. Gale, who testified before the Commission on March 17, 1966² the lands adjacent to the farm consisted of "blow sand" with a thin grass covering, and their poor quality had further deteriorated from having been worked out and inadequately fertilized. Gale, who was an Ottawa real estate broker, made his survey and report³ in 1962 after Valley Farm and Enterprises had begun to operate a dairy farm and had made extensive improvements, including the erection of a very large barn capable of accommodating over 180 dairy cattle. He estimated the market value of all the

⁴Exhibit 1218.

⁵Exhibit 1220.

⁶Exhibit 1231.

¹Exhibit 1211.

²Evidence Volume 11.

³Exhibit 1209.

properties at November 14, 1962 as \$82,700, and concluded that the buildings were much too elaborate for the quality of the land itself which he felt was worth, on the average, somewhere between \$20 and \$25 per acre. A great deal of it was unfenced and such fences as did exist were in poor condition. Evidence given by various witnesses, who testified about conditions during the period in which these properties were operated as a dairy farm, established that there was no water supply available except that which could be purchased from a neighbouring farmer, and that in fact the dairy cattle were kept in the barn and fed on silage and other ingredients purchased elsewhere. Losses from disease caused by inadequate diet were considerable. George Blacklock himself, testifying before the Commission on March 21 and 22, 1966⁴ had considered the land worth an average of between \$100 and \$200 an acre, and David M. Samuel, whom Morgan employed to act as solicitor for Atlantic Acceptance in arranging the transfer of the lands from Blacklock to Blacam Realities and thereafter Blacam Realities to Valley Farm and Enterprises, reported to Morgan that his own inquiries in the area, made on May 24 and May 25, 1961, indicated that it was worth between \$175 and \$250 per acre.⁵ When, however, the assets of Valley Farm and Enterprises were recorded in its books after the conveyance of the land by Blacam Realities to the company on November 30, 1961⁶ it was given a value of \$400 per acre and for this, as will be seen, there was only one explanation.

A Trio Company

The permanent directors of Valley Farm and Enterprises were George Blacklock, W. L. Walton and Harry Wagman; nine \$1 shares, issued but not paid for, were allotted in the proportion of five to Blacklock and two each to Walton and Wagman. Blacklock's five shares were relinquished by him under circumstances which were described by Samuel, and show that Blacklock was reluctant to execute the transfers but yielded to persuasion by Morgan. Morgan's recollection of the circumstances under which Valley Farm and Enterprises was incorporated, as given on his examination for discovery,¹ may well be inserted here:

"A. Well, at that particular time when the company was formed it was formed to clear up some of the problems that Atlantic had with George Blacklock in Cornwall and Ottawa, and in order to control the company these shares were given to me in trust to vote, but the actual physical ownership of them belonged at all times to George Blacklock. Walton and Wagman each received their shares for work they were going to

⁴Evidence Volumes 13 and 14.

⁵Exhibit 1219.

⁶Exhibit 1234.

¹Exhibit 3676.

have to do to keep control of the situation. There was going to be a lot of accounting, supervisory work to be done, and for that reason I sort of held them in nominee trusteeship for George Blacklock. The reason there were five was if Walton and Wagman kicked over the traces anyway these five would represent control of the company.

Q. I take it then you were instrumental in having this company incorporated?

A. Well, what happened was George Blacklock came to me, he was in difficulty financially with our Cornwall office and our Ottawa office and he had Sprawling Farm which at one time was the airport outside of Cornwall was to be built on it, and he had a considerable indebtedness to Atlantic, and when I came to operate the company in August of 1958 full time Davidson was then the general manager of the company, he was in a lot of problems with George Blacklock in connection with the Cornwall automobile business and also the music business which Blacklock operated and which he had borrowed substantial amounts out of both our Ottawa office and our Cornwall office. So in order to consolidate the situation, there was a large number of debts and transactions which were consolidated, and the responsibility for these debts was never at any time denied by Blacklock, so they were consolidated and that was the reason for the formation of Valley Farm. I don't know how far you want to go into that operation of that company, what it did, but it ran for years in connection with the financing of cattle and the operation of Valley Music itself.

Q. You say the company was incorporated primarily to consolidate the indebtedness of Mr. Blacklock to Atlantic?

A. That's correct.

Q. Could you go into some more detail with respect to that?

A. Well, it is very difficult to remember offhand, but in principal Blacklock operated first George Blacklock & Son, the automobile business in Cornwall which went under; he operated the Ottawa Valley Music Company or Valley Music Company, I'm not too certain what it was, which had a route of music, in other words in the cigar stores, in the hotels, in the restaurants, and the purchase of these pieces of equipment were under conditional sales contract and financed by our Ottawa office and financed by our Cornwall office, and gradually through—I don't know whether you call it him taking the money out of the company, but he was always involved financially from the first time I met him which was probably around the fall of 1958 when I turned full time to run the company. He was deeply involved with the company before I even met him.

Q. Excuse me for interrupting you, this is Atlantic?

A. Yes.

Q. I am just saying this to clarify the record.

A. That's right, and so as is usual when you get involved with a customer you try and get him out of his financial difficulties and work the thing out, and his assets were scattered all over and represented this farm, represented an interest in a dozen or so pieces of property in and around Cornwall, and generally speaking what happened is I attempted to consolidate Blacklock and set him up in a business which would enable him to pay off this indebtedness to Atlantic."

To describe this account as Morgan's recollection of what transpired may be ingenuous, because the statement of investments as at August 31, 1962 of Morgan, Walton and Wagman² show the nine shares of Valley Farm and Enterprises divided equally among them. Both Walton and Wagman maintained in evidence that the company was in fact controlled by Morgan, and as far as its operation was concerned this was no doubt true. But, as will become apparent, Valley Farm and Enterprises was treated by the three of them as a Trio enterprise, and it is unlikely that the three partners ever expected it to restore Blacklock to a state of solvency, since they took positive steps which made it impossible for this to occur. Evidence as to what was done was given to the Commission by Mr. K. L. Ingo, C.A. of Clarkson, Gordon & Co.³

"Directors' Loans Payable"

The deed from Blacam Realities to Valley Farm and Enterprises, although dated November 30, 1961 was not registered until February 8, 1962¹ and it was not until the end of that month that the acquisition of the assets thereby conveyed was recorded in the company's books. Debit entries in the general journal² show buildings at \$55,000, farm equipment at \$10,000 and land at \$330,000, or \$400 per acre. The total figure of \$395,000 must be compared with the actual value of the mortgages assumed in the amount of \$198,600, the difference being credited to an account called "Directors' Loans Payable" in the amount of \$196,400. Since the normal procedure would have been to credit this amount to surplus, presumably after appraisal of the value of the assets, these entries should be examined in detail. The first, for February 28, 1962, is a debit for buildings of \$55,000, followed by another for farm equipment of \$10,000 and a credit to "Directors' Loans Payable" of \$65,000, "to charge up value of buildings and farm equipment purchased from G.B." Beneath this for the same date, opposite "Land", is a debit entry of \$330,000 followed by four credits, the first of \$38,600 described as "1st Mortgage Traders", the second for \$10,000 described as "2nd Mortgage C.B.C.", the third for \$150,000 described as "3rd Commodore"

²Exhibits 862.1 and 863.

³Evidence Volumes 11 and 12.

¹Exhibit 1234.

²Exhibit 1259.

and the fourth for \$131,400 as "Directors' Loans Payable—to set up purchase of land from G.B. 825 acres at \$400 per acre." The "Directors' Loans Payable" ledger is account No. 100 in the general ledger of Valley Farm and Enterprises, and the first entry is a debit of \$9 described as "Subscriptions W.L.W.—3.00 H.W.—3.00 C.P.M. 3.00" which, since these books were kept by Walton, Wagman & Co. and were found in their possession, says little for Morgan's contention that he only held five shares in trust for George Blacklock. This entry is followed by a credit of \$65,000, described as " $\frac{1}{3}$ each—Bldgs & Farm Equip." Next is another credit of \$131,400, described as " $\frac{1}{3}$ each—Land", and a credit balance is shown in the amount of \$196,301. No part of this sum was in fact paid by any director or anybody else in cash, and the credit position of the account thus far arises simply from the method of placing these assets on the books of the company by its accountants. Thereafter the next entry is a credit dated September 30, 1962 in the amount of \$25,000, described simply as "deposit", and actually a cash receipt on August 15, 1961. Although at the time when Mr. Ingo gave his evidence the source of this money was unknown, further investigation conducted by the Crown in connection with its prosecution of W. L. Walton and Harry Wagman established that this was a genuine loan made by these two directors, consisting of \$15,000 borrowed from the Canadian Imperial Bank of Commerce by both of them on August 15, 1961, and \$10,000 drawn on the Trio account at the Guaranty Trust Company of Canada by a cheque in favour of Valley Farm and Enterprises and endorsed for deposit "to the account of Harry Wagman in trust for Valley Farm & Enterprises". The next credit appears opposite the date November 15, 1962 and is described as an advance to Barrett, Goodfellow & Co. by C. P. Morgan in the amount of \$12,000 which evidently was connected with the company's trading in securities. The last credit entry of \$10,800 recorded a receipt on May 28, 1963 from Arcan Corporation Limited which, according to a file of Walton, Wagman & Co.,³ represented repayment of a \$10,000 loan in U.S. funds made by Morgan to that company's subsidiary, Westworld Artists Production Inc., in five instalments amounting to \$10,797.37 in Canadian funds between August 23 and September 27, 1962, the exchange being added at an even \$800. The total amount thus effectively credited to "Directors' Loans Payable"—there were other entries which proved abortive and were reversed—was \$244,200.

This account was reduced by a number of payments thereout, the first made on October 19, 1962 by cheque payable to the Canadian Imperial Bank of Commerce in the amount of \$52,247.50.⁴ On the lower left hand corner of the face of the cheque are written the words "re

³Exhibit 1589.

⁴Exhibit 1260.

Walton, Wagman and Morgan.” The three associates in fact had a loan account with the Canadian Imperial Bank of Commerce with a balance outstanding of \$152,247.50 and, according to an entry made on the same date in the ledger for that account,⁵ this payment operated to reduce it to an even \$100,000. The next payment out of the account took place on October 26, 1962, represented by a Valley Farm and Enterprises cheque payable to the Toronto-Dominion Bank in the amount of \$25,000,⁶ and the notation on the face of the cheque in this case reads “Re loan W. L. Walton September 28, 1962.” Among the records of the company a cancelled promissory note was found, payable to the Toronto-Dominion Bank in the amount of \$25,000, signed by Wm. L. Walton and H. Wagman and marked as paid on October 26, 1962.⁷ A third payment was made by cheque dated October 31, 1962, payable to C. P. Morgan in the amount of \$75,000 and endorsed “deposit only C. P. Morgan.”

These payments are recorded as debits to the “Directors’ Loans Payable” account, followed by one for \$123.30 for which no cheque was found by Mr. Ingo, noted as “Toronto-Dominion Bank interest re Arcan.” The cheque was eventually found among papers seized by the Department of National Revenue in Walton’s office⁸ and was offered in evidence by Mr. R. A. Francis of the firm of Harbinson, Glover & Co., chartered accountants employed by the Commission to investigate the purchase of 100,000 shares of Arcan Corporation Limited by C. P. Morgan from one Donald Phillip Owen. This was accomplished by employing the funds borrowed from the Toronto-Dominion Bank in the amount of \$25,000 by Walton and Wagman on September 25, 1962, paid into Walton’s account at the King & Yonge Streets Branch of the bank and withdrawn in favour of Morgan for deposit in his account at the bank’s branch at 25 Adelaide Street West, together with the \$75,000 paid out to Morgan by Walton from the Valley Farm and Enterprises account at the Canadian Imperial Bank of Commerce in Toronto. Although the Walton and Wagman loan at the Toronto-Dominion Bank was made on September 25 and was paid off on October 26 by Valley Farm and Enterprises, only the principal amount had been paid, and it seems reasonable to assume that the payment of \$123.30, endorsed “for deposit only to the credit of account 951610” which was Walton’s, was made to reimburse him for interest paid on \$25,000 borrowed for thirty days at 6% per annum. Then on December 10, 1962 a debit of \$38,000 refers to a cheque drawn on the Valley Farm and Enterprises account,

⁵Exhibit 1261.

⁶Exhibit 1262.

⁷Exhibit 1263.

⁸Exhibit 2999.

payable to Walton and Wagman in the amount of \$38,000,⁹ endorsed "for deposit only to the credit of W. L. Walton and H. Wagman No. 13324," which was deposited in the Trio account at the Guaranty Trust Company of Canada. The final debit to the account of "Directors' Loans Payable" represents a cheque dated June 16, 1965, signed by Wagman and payable to the Canadian Imperial Bank of Commerce in the sum of \$35,000.¹⁰ It is described as "C.I.B.C. (B. Goodfellow)" on the ledger sheet and on the back of the cheque appear the words "re draft V818355". A draft on that bank, dated June 16, 1965, was made payable to Barrett, Goodfellow & Co. in the same amount¹¹ and this is marked "for account W. Pahn". The trading records of W. Pahn with Barrett, Goodfellow & Co.¹² contain a credit entry, marked "by cheque", for \$35,000, dated June 16, 1965, and a letter of February 16 in that year, among the firm's records for the account, reads as follows:

"Gentlemen:

I am the beneficial owner of the account held by you in the name of Walter Pahn.

For taxation purposes only kindly record margin interest charges and coupon interest credits on that account as being part of my yearly dividend and interest statement.

Yours very truly,

'C. P. Morgan' "

It will be noted that this payment out of the funds of Valley Farm and Enterprises was made after the default of Atlantic Acceptance and, like all the other cheques examined, was made for the benefit of Morgan, Walton and Wagman. A credit balance of \$18,820.20 remained in the "Directors' Loans Payable" account thereafter until the bankruptcy of the company.

During the month of October, 1962, therefore, sums in the aggregate amount of \$152,247.50 were paid out by Valley Farm and Enterprises and debited to this account to or for the benefit of two men who were directors and one who was not, and in that month the company received in cash \$125,000 from Aurora Leasing Corporation and \$250,000 from Adelaide Acceptance. The statement headed "C. P. Morgan, Wm. L. Walton and H. Wagman—Statement of Investments as at August 31, 1962,"¹³ so often referred to, shows, under the sub-heading "Loans Receivable", the amount of \$221,391 as owing from Valley Farm and Enterprises and this corresponds with the books of the

⁹Exhibit 1265.

¹⁰Exhibit 1266.

¹¹Exhibit 1267.

¹²Exhibit 507.

¹³Table 30.

company at that date. Although its directors were at that time Walton, Wagman and George Blacklock, no sums were paid out to Blacklock at any time out of the "Directors' Loans Payable" account. When confronted with the evidence of these transactions both Walton and Wagman took the general position that the systematic withdrawal of funds provided indirectly by Atlantic Acceptance to Valley Farm and Enterprises for the private use of themselves and Morgan, and the perversion of accounting principles by which the "Directors' Loans Payable" account was set up, were done at Morgan's direction, and that any shares in the company which they held they considered to be held in trust for him. Wagman, indeed, adopted Morgan's position that the real beneficiary of their activities was George Blacklock. Although it might be instructive to reproduce portions of their evidence on the subject as an example of the confusion produced by mendacity under well-informed questioning, it is unnecessary to do so since both of them pleaded guilty to defrauding Valley Farm and Enterprises of upwards of \$140,000 and were sentenced to two years in the penitentiary, Walton on October 27, 1967 and Wagman on January 16, 1968. The penalties, especially in the case of Walton for whom it was the second conviction for fraud, may well be considered light, but to those imposed by law must be added expulsion from the ranks of an honourable profession the principles and practice of which they had abused throughout their association with the president of Atlantic Acceptance. His complicity is beyond doubt, and it was his hand that guided the conduct of those who must be adjudged subordinate, though equally culpable. An example, out of many pages of testimony, of his attitude under questioning which, in the state of the knowledge of counsel for the trustee in bankruptcy at the time, was not unduly searching, is provided by the following excerpts from his examination for discovery:¹⁴

"Q. Subsequently Valley Farm issued a cheque on or about October 19, 1962, to the Canadian Imperial Bank of Commerce for \$52,247.50 which is charged to this Directors Loan Payable account. Do you have any recollection of why that cheque was issued?

A. This was made to the Commerce.

Q. I have the cheque which may assist you, it was drawn on the company dated October 19, 1964, and if you would look at the cheque it may assist you.

A. It is written by Walton. According to this cheque it is marked 're Walton, Wagman, Morgan loan to Commerce.' Do you know what Commerce records show as having—what did they turn over for this \$52,000?

Q. I don't know, sir, I can't assist you on that.

¹⁴Exhibit 3676.

A. I think it should be looked at and found out for the simple reason that there must be some reason for it, and I think you will find there is some relationship between this cheque and the deposit at the end of the previous month of \$25,000. It may be a purchase, another investment purchase, and I would suspect that is what it is. All I can do is assure you that to the best of my knowledge no fifty odd thousand dollars was taken out of Valley Farm for the benefit of the three beneficiaries here without something being turned in, and I would ask you to ask Commerce what it represents.

Q. Yes, that may come out in our investigation, but at the moment I can't assist you because I just don't know. Do you know if you ever had a loan at Canadian Imperial Bank of Commerce that this cheque might have been issued to pay?

A. It is quite conceivable I did, yes. I was on two or three loans jointly with Wagman and Walton about that time."

Later in the examination counsel returned again to the question of this cheque which had been entered as Exhibit No. 4:

"Q. Mr. Morgan, I direct your attention again to Exhibit Number 4 which is a cheque dated October 19, 1964 (sic), payable to Canadian Imperial Bank of Commerce in the amount of \$52,247.50 and on which there appears the notation 're Walton Wagman Morgan.' We discussed that cheque earlier and I think you stated that it was probably to pay off a loan at the bank or something.

A. Yes.

Q. It is my information that a like amount of money was deposited into an account, I don't know the number of it, headed "Account of Three." Have you ever heard that term before?

A. Account of three, this went into that account, is this what you mean?

Q. Yes.

A. Well, I don't know why it was paid to the Bank of Commerce, and I would like to verify what Commerce say on that because I am not certain just what it entails, but I suggest it quite conceivably could be for an investment of Valley Farm. This I can't give you unless you can give me some information from Commerce.

Q. Have you ever heard of the Account of Three?

A. Account of Three—I don't know what you mean.

Q. You don't know what that means?

A. No.

Q. Did you and Mr. Walton and Mr. Wagman maintain an account called the Account of Three?

A. I never heard of the name Account of Three."

The expression "Account of Three" was used by Harry Wagman in his working papers as a description of the Trio account at the Guaranty Trust Company, and it is unlikely that Morgan did not know what was being referred to. Counsel asked no further questions on the subject, but it is easy to suggest the questions which might have been put and which might have disconcerted the confident evasiveness of the answers already given.

Loans to and by Valley Farm and Enterprises

Before considering the farming operations of Valley Farm and Enterprises its financial position from 1961-1965 should be illustrated. The company's principal sources of funds were Aurora Leasing Corporation and Adelaide Acceptance. The first loan made by the former was received on September 29, 1961 in the amount of \$15,000, and by the end of the year the loan had risen to \$75,000. At the end of 1962 this debt was \$674,200, a year later it stood at \$916,000 and reached its high point on September 30, 1964 in the amount of \$958,000. At the end of that year it had been reduced to \$814,500 and on May 31, 1965 the principal amount was \$873,500,¹ or, in accordance with the accounts receivable of Aurora Leasing including interest accrued and unpaid, a total of \$903,226. No further advances or repayments in respect of principal took place between that date and August 11, 1965 when Valley Farm and Enterprises became bankrupt. The borrowing from Adelaide Acceptance took place on October 29, 1962 and was confined to a single advance of \$250,000; no repayments were made on principal prior to bankruptcy and the amount shown as owing at June 17, 1965, according to the accounts receivable records of Adelaide, was \$254,541. When Mr. Ingo testified the trustee in bankruptcy was unable to say what security, if any, was attributable to these loans and the records of Valley Farm and Enterprises do not refer to the pledging of any. If Aurora Leasing had any security, as was indicated at the time, its nature has not been disclosed to the Commission.

The financial statements of the company were prepared without audit by Walton, Wagman & Co., the first being for the year ended June 30, 1962.² This shows a net loss of approximately \$69,000 for the year. Profits from trading in securities were roughly \$29,000, so that the loss on the farming operation between the date of incorporation and the year-end date was \$98,000, more or less. At June 30, 1963 the company showed a profit of \$64,000 arising from trading profits of \$134,000, offset by a loss on the farm of some \$70,000. Farming operations virtually ceased in November of 1963, and as at June 30, 1964 shareholders equity was in a deficit position of \$162,630; at this point

¹Exhibit 1258.

²Exhibit 277.

and with this deficit the company owed Aurora \$933,500 and Adelaide \$250,000, both exclusive of interest. The picture at June 30, 1965 presented by Mr. Ingo appears opposite.³

This balance sheet was prepared from the books of the company without audit and shows no interest payable on the loans from Aurora Leasing or Adelaide Acceptance. The assets are shown at book value as recorded and a realistic appraisal of land, building and farm equipment would substantially increase the deficit.

The recipient of these large loans, derived from Atlantic Acceptance and apparently unsecured, made substantial loans in its turn. One of these occurred at the beginning of the month in which it received \$125,000 from Aurora Leasing, and consisted of a loan of \$120,000 to C. P. Morgan. It was eventually paid off in March 1964, a final payment of \$36,000 being received from Masco Construction Company, and there is little doubt that this also was derived from Atlantic Acceptance. Morgan paid no interest on the loan and admitted that he used the money for his own purposes, and not to buy securities for the company's account.⁴ Between 1962 and 1964 Valley Farm and Enterprises made payments, either on behalf of George Blacklock or directly to him, amounting to \$93,116 at the date of bankruptcy. One element of this sum was a total of \$37,500 paid to Atlantic Acceptance to reduce the Blacklock Leasing account. Four payments, each of \$5,116, were made in connection with the Valley Music Company's indebtedness to Aurora Leasing between November 1962 and February 1963, and in October of the latter year \$30,000 was paid through David M. Samuel to reduce the principal amount of mortgages given by Blacklock on properties in the Cornwall area. The intention of liquidating the Blacklock Leasing account through Valley Farm and Enterprises was not, however, realized, as has been seen, much less the avowed purpose of consolidating all of Blacklock's liabilities and paying them off through the company's earnings. Although the attempt was made to generate profits through the operation of Valley Farm as a milk producer on a large scale, no contracts were ever concluded with local dairies to establish this function on a sound footing. Since, however, the evidence of how the attempt was made caused a good deal of urbane amusement in the Toronto press during the testimony of Blacklock and his associates before the Commission, a brief account of it must be given.

Conditional Sales of Cattle

Both by environment and of necessity Valley Farm was suited to dairy farming; by environment because Eastern Ontario farming is largely devoted to the production of milk and cheese, and of necessity

³Exhibit 1268.

⁴Exhibit 3676.

VALLEY FARM AND ENTERPRISES LIMITED
BALANCE SHEET
JUNE 30, 1965

Assets		
Cash		\$ 2,931
Investments:		
1,400 shares Analogue Controls	\$ 9,135	
2,000 shares Lucayan Beach Hotel ..	10,000	
Cimcony of Canada		
Ltd.	100,000	119,135
Notes receivable:		
Dallas Holdings Ltd.	182,500	
Associated Canadian Holdings Ltd.	100,000	
Canada Motor Products (Toronto)		
Ltd.	60,000	
Hilltop Holdings Ltd.	42,875	
Canada Motor Products (Blackstone)		
Ltd.	25,000	
Yarrum Investments Ltd.	12,000	
Interest receivable (Dallas \$3,050;		
Hilltop \$430)	3,480	425,855
Advances to director—George Blacklock		93,117
Prepaid insurance		997
Fixed assets:		
Buildings	97,057	
Farm Equipment	41,369	
Silos	4,791	
Automotive equipment	2,385	
	145,602	
Accumulated depreciation	26,476	
	119,126	
Land	342,749	461,875
Organization expenses		470
		<u>\$1,104,380</u>
Liabilities		
Accounts payable and accrued	\$ 20,406	
Directors loans payable	18,820	
Notes payable:		
Aurora Leasing Corpn. Ltd.	\$873,500	
Adelaide Acceptance Ltd.	250,000	1,123,500
Mortgage payable:		
Commodore Sales Acceptance Ltd. ..	117,848	
Hilltop Holdings Ltd.	42,547	160,395
		<u>1,323,121</u>
Share capital	9	
Deficit	(218,750)	(218,741)
		<u>\$1,104,380</u>

because the grazing was too poor to maintain beef cattle. However another plan was superimposed upon it at the suggestion of George Blacklock and Omer Poirier. The idea put by them to Morgan in 1961 was for Atlantic Acceptance to finance the purchase of dairy cattle through conditional sales contracts, in much the same way as it and other companies financed the purchase of automobiles and household appliances. This was a novelty in Canada, although both Blacklock and Poirier asserted that it had been successfully resorted to in the United States. Atlantic was to have recourse, in the case of delinquent contracts, not only to the cattle dealer or drover who made the sale but also to Valley Farm and Enterprises which would at the same time provide a place for the harbouring of repossessed animals until such time as they might be resold. The main problem was one of identification of the chattel itself, and Blacklock was clearly proud of his own solution which was to identify an animal by the number on the tag placed in its ear after tuberculin testing. For its services as endorser and depository Valley Farm and Enterprises was to be compensated by having credited to it a "dealer reserve." A dealer reserve is usually a proportion of the finance charges included in the amount for which a contract is written, but held back from the discounted sum payable to the dealer as a reserve against doubtful accounts. Originally, in 1961, Omer Poirier was to be the only franchised dealer in the area served by the Cornwall office of Atlantic Acceptance and full recourse was to be had to him on each contract; in the event of his being unable to repay recourse would be to Valley Farm and Enterprises which would also repossess any animals as occasion arose. For this the company was to be credited with \$10 for every cow sold.¹ On August 9, 1961 the allowance was changed to 5% of the amount advanced and was increased to 10% by the end of the year.² This unusual method of calculating dealer reserve was altered on January 3, 1963,³ to be thenceforth 27½ % of the finance charges. In fact it was not apparently intended ever to look to Poirier himself, although some payments were made by less-favoured dealers; moreover, no payments out to Atlantic Acceptance were made by Valley Farm and Enterprises in cases of default by purchasers. Yet the accumulated reserve was completely paid out to the company by Atlantic at the end of each month, and the wasteful system of rewriting contracts for a delinquent purchaser to buy additional cattle, when he could not afford to pay for those for which a conditional sale had already been made, was instead resorted to. Since a dealer reserve is set up to protect a finance company against the incidence of bad debts, to provide protection against adjustments on the payment of a contract in

¹Exhibit 1569.

²Exhibit 1508.

³Exhibit 1510.

advance of its due date, and to provide it generally with some security over the life of the contract, the monthly remittance to Valley Farm and Enterprises of all the accumulated dealer reserve from cattle sales constituted unusual and preferential treatment in its favour, at the expense of Atlantic Acceptance and contrary to its interests.

The minutes of meetings of the board of directors of Valley Farm and Enterprises record on October 11, 1962 the fact that Atlantic Acceptance had agreed to pay "to the Company 10% of the unpaid balance of all conditional sales contracts, chattel mortgages, or other negotiable instruments relating to livestock and farm equipment which Atlantic might purchase if the Company would guarantee payment thereof."⁴ There is no reference to any written agreement between the parties, and it is safe to say that none was ever entered into since none has been found in the records of either Atlantic or Valley Farm and Enterprises. No doubt it was preferable from Morgan's point of view not to reduce the arrangement to the terms of a written agreement, thus inhibiting that type of adjustment which might be necessary to make sure that the payment out of dealer reserve to Valley Farm and Enterprises was profitable to the latter, if not to Atlantic. The former in fact received credit for dealer reserves on all "cow paper" purchased in Ontario, and the financing of the purchase of dairy cattle was conducted not only through the Atlantic Acceptance branch at Cornwall but through other branches advantageously situated for this type of business at Brockville, Ottawa, Kingston, London, Listowel, Pembroke, Peterborough, Stratford and St. Thomas. Since it was uneconomical for Valley Farm and Enterprises to repossess and maintain cattle in the western part of the province, one John Walker, a drover in St. Thomas, was commissioned by the company to perform the function in this area. In December 1962 the practice of looking to cattle dealers for payment on contracts in default was abandoned in principle—it had never been much resorted to in practice—and thenceforth new contracts were to be free of this provision, Atlantic Acceptance looking only to Valley Farm and Enterprises.⁵ In consequence a fresh incentive was provided for dealers to sell additional cattle to customers bound by existing contracts, so that these could be rewritten omitting the provisions for recourse against themselves. These changes in plan produced considerable confusion in the finance company's branch offices, and early in 1963 the accounting work in connection with dealer reserve was centralized in the head office at Oakville. Since the accumulated reserve was paid out monthly and *in toto* to Valley Farm and Enterprises, Atlantic had really no security for moneys advanced to farmers to purchase cattle

⁴Exhibit 275.

⁵Exhibit 1509.

except their promissory notes and what could be recovered by repossession. Repossessions were in fact infrequent, and it appears that in most instances Valley Farm retained whatever was realized from the sale of repossessed animals.

Analysis of Atlantic Dealer Reserve for Valley Farm

Mr. McLoughlin analysed the Valley Farm and Enterprises accounts showing amounts credited to commission income from this source, and those of Atlantic Acceptance showing that company's cheques paid to Valley Farm and charged to its dealer reserve. Credits to Valley Farm dealer reserve account were made by Atlantic beginning in July 1961, or the month before the company was incorporated, George Blacklock having been registered under the Partnerships Registration Act at L'Original as carrying on the business of Valley Farm as sole proprietor. By the end of the year the total amount credited was \$47,177.17 of which \$24,165.28 related to business originating in the Cornwall branch. From January 1, 1963 to June 30, 1963 the total amount credited was \$51,583.18, but for the rest of the year this rate of progress was not maintained; the amount credited between July 1, 1963 and January 31, 1964, after which no further credits were made, was \$27,441.25.¹ The total amount paid to Valley Farm and Enterprises by Atlantic Acceptance, either directly or to others on the latter's behalf, by cheques charged against the dealer reserve was \$115,313.54, and the last cheque was issued in October 1963.² None the less, because of the failure of Atlantic to seek recourse against the company, debit balances arose in this account and at June 30, 1965 had been written off to a total amount of \$21,701.27. As a result of the general tendency to maintain delinquent accounts in a current position by rewriting contracts, no writing off of amounts owed by conditional purchasers occurred until February 1964, and then only on a small scale. It was not until 1964, when farming enterprise and cattle financing alike had been recognized as unsuccessful, that major write-offs took place amounting during the year to \$205,534.30. The total value of cattle and farm equipment contracts written off was \$227,235.57.³ If this amount is added to those paid out monthly to Valley Farm and Enterprises by way of dealer reserve, the whole loss endured by Atlantic from engaging in this type of business was \$342,549.11, assuming that Atlantic records correctly identified all the write-offs of cattle-purchase contracts, an assumption which Mr. McLoughlin found it difficult to make.⁴ Morgan told counsel for the trustee in bankruptcy that the cattle financing business was lucrative, and that he considered Atlantic's pioneering in the

¹Exhibit 1563.

²Exhibit 1566.

³Exhibit 1565.

⁴Exhibit 1566.

field as a profitable venture. This view was shared by only one of the members of the staff of Atlantic who were examined by the Commission, an area manager by the name of Irvine who supervised the Cornwall and Brockville branches, but who had left the company's employ before the scale of delinquency had become apparent. Generally speaking, the branch managers and head office employees examined by the Commission neither took the enterprise seriously nor understood what management was trying to do. This is not surprising in view of the anomalous position of Valley Farm and Enterprises, for the benefit of which substantial sums were being paid out monthly in the form of remittance of dealer reserve, and from which nothing was being collected by way of "net pay-out" on contracts in default. Had this company, operated ostensibly for the benefit of George Blacklock but actually for that of Morgan, Walton and Wagman, played the rôle proclaimed for it, much of the Atlantic loss would have been transferred to it, but it is doubtful if cattle financing would have been profitable, even if properly managed, because of the slim resources of most of the purchasers who were attracted to it, generally after the banks had ceased to find them credit-worthy.

Local Operations of George Blacklock

While Harry Wagman kept the books in Toronto and made only rare and, as one would think, unobservant visits to Cornwall and Riceville, George Blacklock managed the farm, which was expected to sustain itself by selling milk produced by its herd of upwards of 180 Guernsey cattle. Between June and November 1961 Blacklock, who was paid \$135 a week by Valley Farm and Enterprises, almost succeeded in ruining the farming operation before it had fairly started. In the latter month he was superseded by W. J. Ballard, an Atlantic employee who had acquired a diploma from the Ontario Agricultural College, and who found the barn uncompleted, large numbers of cattle sick from being improperly and inadequately fed, and the credit of Valley Farm with local merchants and suppliers non-existent because of Blacklock's established reputation. Under many difficulties, which included constant interference from Blacklock, Ballard succeeded in restoring health to the herd and some degree of order to the affairs of the farm; but since he got little support from Wagman, he quit his job in 1962. Blacklock resumed his direction of affairs, assisted by H. J. Spanton from Morgan's own office, until October 1962; thereafter until November 1963 Blacklock ran the farm downhill to the point where Morgan felt that its operations had to be curtailed, together with any rehabilitation of Blacklock's financial affairs. During this period Blacklock was also receiving \$60 a week for his efforts on behalf of Valley Music Company and here, also, Spanton was at his side. The profitability of this enterprise was necessary to make monthly payments to Aurora Leasing and to

reduce the debit balance in the Blacklock Leasing account. Nevertheless Blacklock appeared to be mainly anxious to put money into his own pocket, and traded extensively in used cars for which he received cash in what he described as "back-pocket deals." He maintained a collateral loan account with the Canadian Imperial Bank of Commerce in Cornwall in which he was supposed to make deposits to reduce his heavy indebtedness to that institution, but under questioning by Mr. Cartwright it appeared that his book-keeper, Mrs. Enid Mario, had an account at the same branch which also received deposits from George Blacklock and on which she drew for his benefit.¹ Blacklock's candid explanation of this arrangement is worth reproducing.²

"MR. CARTWRIGHT: Mr. Blacklock, I think you have already told us yesterday that you were heavily indebted to the Canadian Imperial Bank of Commerce during this period 1959 to 1963?

A. Yes, sir.

Q. And during this period there was in operation a collateral loan account in your name at the branch in Cornwall?

A. Was for notes that were there, and that people would pay on them and they would credit the collateral account with.

Q. And the bank would resort to this collateral loan account from time to time if funds were available, in order to alleviate your indebtedness to the bank?

A. That is right.

Q. Correct, sir?

A. Right.

Q. During this period you also had in effect your current account?

A. Yes, I was afraid to leave any money in it for fear they would grab it.

Q. Right, and because of that reason, you asked Mrs. Mario, who is an employee of yours, to open a savings account No. 979 at the branch?

A. That is right.

Q. Into this savings account you placed funds during this period?

A. I would buy a car and sell a car, and if I got some money I put it in.

Q. Right.

A. By her put it in, take it out.

Q. You would agree with me that all funds that went into account No. 979 during the period of operation which we see before us, were funds which belonged to you?

A. That is right. Sir, if I may add at this time—

¹Exhibit 1340.

²Evidence Volume 14, pp. 1854-61.

Q. Go ahead.

A. I had a mortgage on a property, this farm in question, and it burned and I got \$10,000.00 personally out of that.

Q. From time to time, sir, during the period of August 1959 and the end of April 1963, you would have funds taken out of account No. 979, and all or part of the funds would be transferred to your current account?

A. To cover the outstanding cheques, yes.

Q. Right, to cover outstanding cheques on your current account, so that it would always be maintained at a minimum balance?

A. That is right.

Q. Now, those funds which you received to place in account No. 979, where did those funds come from?

A. Well, I had the money (\$12,000.00 or so) from the sale of the farm machinery, and I had \$10,000.00 from the fire.

Q. Perhaps you might deal with some particular items and you might be able to assist us. For example, just taking again number 979, sir, on the credit vouchers (which are Exhibit 1343) we see a deposit on August 6th 1959 made up of bills; one one-dollar bill, one five-dollar bill, three ten-dollar bills and twelve 100-dollar bills, for \$1,236.00. Now, where would that type of money come from?

A. Could have been from the sale of a car; part of my \$10,000.00. I don't really know to tell you the truth.

Q. I see. Now, the sale of your cars, were you running an organized business at this time?

A. Well, I mean, a back pocket proposition.

Q. Perhaps you might explain to me?

A. The thing is, I was so badly in debt that if I showed anything, somebody was going to grab it, so I didn't have no choice in the matter.

Q. Let us deal with the back pocket proposition first. How would that work?

A. I might have bought something for cash and got cash for it.

Q. I see. Now, there is another deposit, sir, the next one that follows on August 28, 1959, to that account, of \$1,150.00 in cash, represented by one \$50 bill and eleven \$100 bills. Where would that money come from?

A. I would only be guessing. You are talking about something that happened seven years ago. I can't tell you. I can guess, but I would only be guessing. You don't want guesses. I don't want to be obstinate.

Q. Just passing through very quickly, there is another deposit on October 6, 1959 in cash of \$1,755.00?

A. I couldn't say.

VALLEY FARM

Q. You couldn't say for that. Another one on November 3rd 1959 of \$2,350.00. Any idea where that money came from?

A. No, sir; not at this late date.

Q. Another one, sir, on February 9, 1960, \$1,608.00 in cash?

A. I wouldn't know.

Q. You wouldn't know?

A. I would only be guessing.

Q. Here is a deposit—

THE COMMISSIONER: Mr. Blacklock, what would you guess it would be?

A. Well, I had this money and I was working with it. It could have been from anything; could have been a couple of cows bought and sold a couple of cows, or it could have been a truck I bought or sold a car—could have been anything. I don't want to be evasive, but you are talking about seven years ago.

Q. But you think it was derived from the sale of cars and cattle?

A. That is right, because I had this money and I was working with it and if anybody—if I produced it, they would have jumped on my back and I would have had nothing.

Q. How were you trading in cattle at this time?

A. I used to buy a few cows and sell them to packers; go to the auction and buy them. With my reputation, I had to pay cash. I couldn't get it, I got too badly involved financially.

MR. CARTWRIGHT: Mr. Blacklock, there is another deposit with the bank stamp of April 11 1960, of \$600.00. I assume your signature on the face of the deposit slip?

A. I put it in.

Q. I am not taking every one, sir, as you can appreciate. We will just pass through some of the larger ones. Another one on May 3rd 1960 for \$850.00?

A. Yes.

Q. If you see an explanation to any one of these, just call out. Another one here on May 26, 1960 for \$1,125.00. June 24, 1960, a thousand dollars. Does this refresh your memory at all?

A. No, I am sorry.

Q. Here is one on November 17, 1960, \$2,900.00 in cash?

A. No.

Q. Just passing along very quickly, another one on February 21st, 1962, \$600.00 in cash?

A. It was a case of in and out, in and out, Mr. Cartwright.

Q. Another one on March 15, 1962, \$595.88?

A. I am sorry, I cannot help you at all.

Q. All right, sir. The last one we note, August 21, 1962, \$1,198.75 was the net deposit.

A. Looked like a cheque.

Q. Looked like a cheque here for \$1,200.00, sir?

A. Could well have been.

Q. Because there is a note on the back that the exchange was \$1.25?

A. Yes.

Q. So the infusion of funds in this special account arises from your cattle deals and your—

A. Car deals.

Q. Car deals?

A. That is right."

As this evidence proceeded and covered deposits in his own current account, Blacklock became more and more sensitive about certain deposits that were put to him, particularly one of \$90 in silver about which he showed some agitation. Since he regarded Valley Music Company, which operated record-playing machines, as indistinguishable from himself, this unexplained deposit of \$90 in silver is highly suggestive. No doubt allowances from Valley Farm and Enterprises and Valley Music Company were not enough to satisfy his needs, and with all his indebtedness and some \$40,000 in judgments against him he was desperate for money. A final attempt was made to liquidate Blacklock's debt to Atlantic Acceptance by conveyance from Blacam Realities of all its remaining properties to Valley Farm and Enterprises which was, in turn, to raise money on them by a mortgage to the Auer Mortgage Company of Detroit through the efforts of Donald W. Reid of London. This proved to be abortive because of the number of executions against Blacklock personally, which encumbered the title and which Valley Farm and Enterprises was apparently not prepared to lift.

General Spray Service and Phantom Industries Debentures

Enough has already been written to show that the main purpose of Valley Farm and Enterprises in Morgan's plans was trading in securities, and especially such as the shares of Commodore Business Machines and of Analogue Controls, for which he was actively operating the market. At June 30, 1965 the company still held 1,400 shares of Analogue with a book value of \$9,135, and 2,000 shares of Lucayan Beach Hotel and Development valued at \$10,000. Two transactions were

unusual and irregular from an accounting point of view. On November 6, 1962 the company bought \$30,000 of the debentures of General Spray Service Inc., a heavy borrower of Atlantic funds, through Annett Partners, bearing interest at 7% per annum, for the sum of \$32,296.88. According to the evidence of W. E. Butlin, at the time head of Atlantic's "Industrial Division" located at 100 Adelaide Street West,¹ the three \$10,000 debentures were lodged with him in negotiable form by Harry Wagman in the same month, and were used as collateral security for a loan by Atlantic to Valley Farm and Enterprises. The cost of the debentures was charged against operations for the year ended June 30, 1963 and they do not appear on the balance sheet as an asset; yet interest was paid on them to the company on April 24, 1964. These debentures were compromised on March 11, 1964 for 25% of their face value, 2½% to be paid in cash, 7½% in further payments and 15% participation thereafter. Two further payments of \$750 in U.S. funds were received in 1964 testifying to their existence.² A purchase of \$125,000 worth of 6% debentures of Phantom Industries Limited for \$127,761.80 from C. P. Morgan, through Jenkin, Evans & Co., was similarly treated for the year ended June 30, 1964. Interest was paid on these debentures on December 31, 1962 and again at the end of 1964. There is no record of any sale of either the General Spray Service or Phantom Industries debentures. The certificates for those of Phantom Industries, with five others of the same issue amounting to \$475,000, were turned over to A. G. Woolfrey for safe-keeping in November 1964. Woolfrey's testimony about this transaction³ amounted to a denial that any of the Phantom Industries debentures were pledged as security for a loan to Premiumwares Limited, a company controlled by one Harrison Verner which specialized in the provision of books and other novelties to grocery stores. He was simply asked to have them registered in his own name "for purposes of voting" and to take his instructions as to their disposition from David M. Samuel and Theodore Sherman, a chartered accountant representing Verner.

Phantom Industries was a manufacturer of silk stockings and at the time in receivership. Premiumwares, according to Woolfrey, assigned as security for a loan from Commodore Sales Acceptance, which was still outstanding at June 17, 1965 in the amount of \$449,534.10,⁴ a considerable amount, if not all, of its inventory. The deposit of \$475,000 of the Phantom debentures, together with 52,500 of its common shares, with Commodore Sales Acceptance, or to put it specifically with Woolfrey himself, was described by him as a pledge of good faith by Verner. The "acknowledgment of trust" executed by Samuel and Sherman on No-

¹Evidence Volume 14.

²Exhibit 2320.

³Evidence Volume 14.

⁴Exhibit 578.

vember 20, 1964,⁵ in which they averred that they each held an undivided one-half interest in these securities pursuant to unstated "trust arrangements", provides for the same arrangements "if, as and when the Bank of Montreal releases the \$399,000.00 principal amount of Leland Publishing Limited debentures and 96,513 Leland Publishing Limited common shares." Leland Publishing Limited was another of Verner's companies from which Premiumwares acquired inventory in the shape of 950,000 books after the former had been placed in bankruptcy. The loan by Commodore Sales Acceptance does not appear to have been made to Premiumwares until December 24, 1964, or in the month following the disposition of Phantom Industries debentures which has been described. Suffice it to say that the debenture for \$125,000 purchased by Valley Farm and Enterprises from C. P. Morgan was slipped into the bundle of debentures and shares entrusted to Woolfrey, with no apparent relation to Verner's "pledge of good faith." The instructions to Woolfrey as to registration were contained in a letter of March 4, 1965, addressed to Commodore Sales Acceptance, "attention Mr. Albert G. Woolfrey", authorizing registration of the \$475,000 worth of Phantom Industries debentures "in your name and to vote for the acceptance of a proposal put forth by the said company."⁶ It is not clear from the text of this letter whether the debentures were to be registered in the name of Commodore Sales Acceptance or Woolfrey personally, but Woolfrey evidently interpreted it in the latter sense. The purchase of the General Spray Service and Phantom Industries debentures, accomplished with Atlantic funds, was a virtually complete loss to Valley Farm and Enterprises, and in the case of the Phantom Industries transaction put \$125,000 in C. P. Morgan's pocket and debentures in that amount at his disposal.

Loans Outstanding at June 30, 1965

The notes receivable of Valley Farm and Enterprises as at June 30, 1965 amounted in the aggregate to \$425,855 and were made up as follows:

Dallas Holdings Limited	\$182,500
Associated Canadian Holdings Limited	100,000
Hilltop Holdings Limited	42,875
Canada Motor Products (Toronto) Limited	60,000
Canada Motor Products (Blackstone) Limited	25,000
Yarrum Investments Limited	12,000

These amounts, not including accrued interest, were outstanding at the date of the company's bankruptcy. Dallas Holdings, as already seen, was

⁵Exhibit 1364.

⁶Exhibit 1365.

VALLEY FARM

a private company incorporated in 1955, and until November 1961 was under the control of Rennie A. Goodfellow when it was acquired by C. P. Morgan, W. L. Walton and Harry Wagman. Loans were made to this company by Valley Farm and Enterprises from the beginning of 1962, and at June 30, 1965 Dallas Holdings was indebted in the principal amount of \$182,500 with interest accrued of \$3,480. This represented 18% of the total liabilities of Dallas Holdings at this date, compared with loans from Aurora Leasing of \$678,850 representing 65%. The loan arose from the sale to Dallas of 50,000 shares of Commodore Business Machines.¹ The amount of \$100,000 due from Associated Canadian Holdings, the company in which Morgan and his wife had a fluctuating interest but never less than one-third, was the outstanding balance of a much larger indebtedness of \$346,520, also incurred from a sale of Commodore Business Machines shares, which had been reduced in July 1963 and on which no interest was thereafter charged. Hilltop Holdings had assumed in May of 1963 the first mortgage given to Traders Realty Limited by Blacklock on the lands of Valley Farm, and the amount of \$42,875 paid for the assignment had been advanced to it by Valley Farm and Enterprises which then owned the property, because, as Morgan said, there existed considerable ill-feeling between Blacklock and the management of Traders Realty. Canada Motor Products (Toronto) Limited, a company managed by Nathan Saunders, was successor to the business of Canada Motor Products Limited, owned and operated by Israel Gringorten and members of his family, to which Commodore Sales Acceptance had advanced some \$238,000 before its bankruptcy in April 1962. The trustee in bankruptcy of the latter and older company was William L. Walton and, after the Gringorten family had been forced out of the business, Walton and Wagman instructed Hubert J. Stitt, a lawyer with offices in both Toronto and Chicago, to incorporate the new company. By the end of 1962 the directors were L. Murray Eades, John Canning and Shirley Fruitman, nominees for the Trio. The principal lender was again Commodore Sales Acceptance which advanced \$200,000 on the security of a debenture on which no interest was charged.² The company was subsequently renamed Gassem Enterprises Limited, and the loan by Valley Farm and Enterprises was advanced as to \$45,000 on December 28, 1962, and as to \$15,000 on January 6, 1963, and remained unpaid.³ Canada Motor Products (Blackstone) Limited was incorporated on January 29, 1963, on instructions given to Stitt, to be jointly owned by Canada Motor Products (Toronto) and the Blackstone Manufacturing Company Incorporated of Chicago a leading American producer of automobile parts. The

¹Exhibit 4109.

²Exhibits 1857.1 and 3050.

³Exhibit 3055.

\$25,000 advanced by Valley Farm and Enterprises lent to a company which lost over \$70,000 in its first and only year of operation, not surprisingly remained unpaid, and the amount payable is not even recorded in its books. Dallas Holdings, Canada Motor Products (Toronto) and Yarrum Investments were all involved in transactions connected with the underwriting of the shares of Dale Estate Limited in which the Trio participated with Annett & Co.⁴ The loan to Yarrum Investments was made on May 31, 1965, and no interest appears to have been charged to this Trio company.⁵ Also outstanding at June 30, 1965 was an advance of \$100,000, represented as having been made on May 1, 1963 for shares of Cimcony of Canada Limited, and debited to a suspense account from which it was never re-allocated. It has been seen⁶ that shares in this company were never issued to Valley Farm and Enterprises because of George H. Weinrott's rooted conviction that Cimcony of Canada belonged to him, and the money was treated as a loan and never repaid. The amounts shown as outstanding on these notes receivable and the advance to Cimcony of Canada on the balance sheet for June 30, 1965 were not in any way reduced at the date of bankruptcy of Valley Farm and Enterprises. Loans made by the company, but not outstanding at June 30, 1965, have not been enumerated. That of \$120,000 to C. P. Morgan, mentioned above, and two totalling \$10,000 to Fun-A-Marin Limited, of which Morgan held more than half the shares, are typical of those which were subsequently repaid but on which no interest was charged.

The Racing Stable

The story of Morgan's efforts to rehabilitate George Blacklock and save Atlantic Acceptance from the consequences of its lavish lending to him would not be complete without some reference to the fortunes of Valley Farm Stable on the turf. Morgan, as has been said before, was an inveterate gambler and racing was one of his principal recreations. He drew his closest associates, W. L. Walton and Harry Wagman, into the sport with him, no doubt with the comforting assurance that any profits derived from it would accrue to Valley Farm and Enterprises and be theirs to divide with him, and any losses would be borne by the company and not become their personal liabilities. The secretary-treasurer of the Ontario Racing Commission, the assistant treasurer of the Jockey Club Limited and Mr. McLoughlin gave evidence about this activity¹ and a number of documents were produced, including racehorse owners' licence applications by Walton and Wagman

⁴Chapter VIII, pp. 356-61.

⁵Exhibit 1259.

⁶Chapter IX, p. 602.

¹Evidence Volume 23.

VALLEY FARM

beginning in 1962, by Walton, Wagman and Morgan in 1963, and by Morgan alone in 1964, were offered in evidence.² Applications for the registration of racing colours³ and for the registration of the stable name⁴ indicate that the operation of Valley Farm Stable was a joint venture of the Trio. Mr. McLoughlin's evidence shows conclusively that all the book-keeping was done by Walton, Wagman & Co. within the books of Valley Farm and Enterprises, and that it was upon this company that the costs and, indeed, the ultimate loss invariably fell. Four horses were involved; the first, by the name of "Pillan Mapu", was purchased in December 1961 for \$3,300 and its cost was written off on June 3, 1964. This horse was both the first and last of the string, the other three having been entered in claiming races and duly claimed. The loss to Valley Farm and Enterprises on the purchase and disposal of these horses amounted to \$3,250.⁵ Income from purses in the years ended June 30, 1962, 1963 and 1964 amounted in gross to \$22,861.50, and to a net amount of \$15,693.10. After deduction of training and other expenses, the loss on racing operations accumulated for the three years was \$7,440.55⁶ which, added to the loss on acquisition and disposal of horses, amounted in all to \$10,690.55.⁷ This, in the scale of losses suffered by Valley Farm and Enterprises, is moderate enough, but the fact that it was suffered by the company, and not by the sportsmen who incurred it, is sufficient evidence of the mixture of cynicism and frivolity with which the Trio conducted the company's affairs.

Summary of Atlantic's Losses Through Valley Farm and Enterprises

Any endeavour to make an exact estimate of the losses of Atlantic funds through the operations of Valley Farm and Enterprises and loans made to George Blacklock would be an excessively complicated task, involving the reconciliation of a multitude of accounts and not attempted in the evidence given to the Commission. Much of the profit made on transactions and securities was at the expense of other companies to which Atlantic Acceptance had made loans of an unprofitable nature. Many of its losses enured to the benefit of Morgan, Walton and Wagman and the companies which they owned or controlled. Finality is impossible until results of the efforts of the Clarkson Company as trustee in bankruptcy are known and declared, not to mention its far-ranging activities as liquidator and trustee of many other companies the affairs of which impringe upon those of Valley Farm and Enterprises. Certain figures, however, indicate what the extent of the loss may be. At June

²Exhibits 1891-2, 1894-6 and 1899.

³Exhibits 1893, 1897 and 1900.

⁴Exhibits 1898 and 1901.

⁵Exhibit 1906.

⁶Exhibit 1911.

⁷Exhibit 1912.

17, 1965 the accounts receivable of Aurora Leasing Corporation showed as owing to it by the company \$903,226, and those of Adelaide Acceptance \$254,541, the variance in these amounts from those shown on the unaudited balance sheet of Valley Farm and Enterprises prepared as at June 30, 1965 being evidently due to the accrual of interest not recorded in the company's books. The accounts receivable of Commodore Sales Acceptance at the same date show a debt of \$118,175.15 as owing on the mortgage of the lands of Valley Farm, or nearly five times what the trustee expects to recover by the sale of the property. The release of dealer reserves by Atlantic Acceptance, either directly to Valley Farm and Enterprises or to others on its behalf, has already been noted as amounting to \$115,313.54.¹ In this connection, as has also been seen, Atlantic Acceptance wrote off accounts receivable from purchasers of cattle, for which no recourse was taken against the company, in the amount of \$227,235.57. Then the excess of disbursements over receipts in the Blacklock Leasing account, the amount owing on the Blacam Realities mortgage to Atlantic Acceptance and the Atlantic capital loan to George Blacklock were all written off in the aggregate amount of \$354,184.57, and the \$93,116 owed by George Blacklock on advances referred to as "real estate deposits", or payments made to reduce the Blacklock Leasing debit balance made by Valley Farm and Enterprises, must be taken into account. All these sums amount to losses of \$2,065,792 and the trustee in bankruptcy expects to recover from the assets of Valley Farm and Enterprises only some \$55,000.²

¹Exhibit 1566.

²Exhibit 5124.

CHAPTER XIV

Other Major Loans

Hitherto I have dealt in separate chapters with situations which illustrate different aspects of the lending of the funds of Atlantic Acceptance Corporation, beginning with the modest but significant transactions by which John Belli Operations Limited was financed and manipulated for the benefit of C. P. Morgan, W. L. Walton and Harry Wagman, frequently described as the Trio, and ending with a short treatment of the history of Valley Farm and Enterprises Limited, a Trio company the operations of which were in part typical of those of other Trio companies such as Dallas Holdings Limited and Yarrum Investments Limited, but, like Aurora Leasing Corporation ostensibly engaged in a business other than lending money and trading in securities. Before turning to the subject of British Mortgage & Trust Company, a distinct but not wholly separate study, and returning thereafter to consider the financial and accounting problems of Atlantic Acceptance, I propose in this chapter to examine briefly the affairs of those borrowers not previously dealt with in detail which, because of the size of the loans made to them and allowed to grow without control and adequate security, played a leading part in causing its downfall. All of the loans were made by the group of companies under the hand and eye of C. P. Morgan in the executive offices at 100 Adelaide Street West in Toronto: Commodore Sales Acceptance Limited, its subsidiary company Commodore Factors Limited, Adelaide Acceptance Limited and Aurora Leasing Corporation Limited, the last of which was only physically dissociated from the others by reason of its situation in the offices of Walton, Wagman & Co. and its successor firm Wagman, Fruitman & Lando. All of these lenders derived their funds from the operations of

Atlantic Acceptance as a sales finance company conducted from the head office at Oakville and the profits generated by their own. The effect of the loans to be described was to immobilize upwards of \$10,000,000 of its assets, alone sufficient to destroy its liquidity in the crisis of 1965.

1

The General Spray Group

At an unusual meeting of the board of directors of Atlantic Acceptance Corporation held in March 1964, not in the executive offices at 100 Adelaide Street West but in the head office building at Oakville, questions were directed to the president about the possibility of delinquency in the category of large loans. The lead was taken by J. A. Medland and by Alan T. Christie, president of Great Northern Capital Corporation which held at the time 49% of Atlantic's common shares, and C. P. Morgan replied that there were only four which were causing concern. Christie took away with him a pencilled note on a piece of scratch-pad paper on which he had written the following:¹

"Gen Spray	\$600,000	
	100,000	
	<hr/>	
	\$500,000	
Treasure Island	500,000	10%
Eastgate Motors	700,000	
Phantom	300,000"	

At the same time the directors were assured, in Christie's words, "that there were not any important difficulties in here that were not recoverable or reserved against".² Of the four companies General Spray Service Inc. was the one which Christie would have known most about and which should have provoked further inquiry. The accounting evidence about it was given to the Commission by Mr. J. N. Ross, C.A. of Clarkson, Gordon & Co.³ in December 1966 and embraced other companies connected with it, by name, Sprayfoil Corporation, Turf Kings Inc., Turf Kings Leasing Inc., American-Marsh Pumps (Canada) Limited, American Automation (Canada) Limited and General Lawn Spray Limited. General Spray Service was incorporated in New York State on April 24, 1956, with Francis H. Hoge Jr. as beneficial owner of the ten shares originally issued.⁴ In 1959 the company acquired title from Hoge to a patented spraying device called the "Agi-Sprayer" which he caused to be mounted on trucks for the spraying and fertilization of lawns. The company sold distributorships from its headquarters at Katonah, N.Y. in various parts of the United States and,

¹Exhibit 3646.

²Evidence Volume 91, p. 12366.

³Evidence Volumes 40-3.

⁴Exhibit 2312.

through the distributors, trucks, pesticide and fertilizer to franchised operators. Hoge, who was regarded by all the witnesses who testified before the Commission as a salesman of superior persuasive powers, was well qualified to preside over this stage of the company's development. It issued a prospectus dated September 19, 1961⁵ in respect of 100,000 shares of its Class "A" stock which had voting rights with one warrant for each share attached, plus a further 15,000 warrants; the units were to be sold to the public at \$3.50 each and a registration statement was filed with the Securities and Exchange Commission in Washington. Hoge retained control by converting his original 10 shares into 230,000 shares of Class "B" stock, convertible into Class "A" and having two votes per share, and thus was in a position, as stated in the prospectus, to elect all the directors himself. The shares were sold on October 9, 1961 but the talents of Hoge were unequal to the management of a public company, and in 1962 further financing was required.

Carman G. King, when he testified to the Commission on June 13, 1966,⁶ said that C. P. Morgan suggested to Hoge that he see Annett & Co. in Toronto, and King first saw him in the spring or summer of 1962. Hoge told King that Atlantic Acceptance was already financing the trucks which General Spray Service sold to its franchised operators and the records of Commodore Factors Limited indicate that these loans began on March 13, 1962, secured by the assignment of lease-purchase agreements;⁷ by December 31, 1962 the contingent liability of General Spray Service to Commodore Factors amounted to \$297,728 in U.S. funds. King had friends of his in New York observe the operations under franchise and make inquiries; after General Spray Service acquired control of Sprayfoil Corporation in Minneapolis on September 27, 1962 and the rights to the use of the "Sprayfoil" device, King's mind was made up, and in November Annett & Co. bought \$100,000 worth of General Spray Service 7% convertible debentures for the accounts of Mrs. Kathleen Christie and Valley Farm and Enterprises as to \$30,000 each, \$30,000 for himself and \$10,000 for Clarence M. Fines, the former Provincial Treasurer of Saskatchewan, with whom he was associated in the development of properties in the island of Grenada. King said that the Valley Farm purchase was Morgan's commitment and was regarded as one of his accounts.

"Sprayfoil" was a patented device, simulating the wing of an aircraft from which it had been observed by the French inventor that the rain was thrown off at certain angles in the form of a fine mist. It had been developed by Sprayfoil Corporation of Minneapolis for horticultural and agricultural use and great things were expected of it as a

⁵Exhibit 2311.

⁶Evidence Volume 43.

⁷Exhibit 2321.

means of spraying cattle. The company was incorporated in Minnesota on April 29, 1959; its annual report for 1962⁸ shows that between April 29, 1959 and April 30, 1962 it had raised \$783,464 in equity capital and had incurred a deficit of \$650,721, together with deferred research and development costs of \$157,137. On September 27 of that year a shareholders meeting approved the sale of a 90% interest in the company to General Spray Service by the issue to the latter of 3,874,500 shares from its treasury. Holders of the previously issued shares had formed a new company called Sprayfoil Industrial Corporation which assumed the debenture debt of Sprayfoil of \$157,470, receiving in return the "Canadian patents", as they were described, and leaving Sprayfoil Corporation itself with only a licence to the patent rights in certain defined areas. Sprayfoil Industrial Corporation also received cash of \$7,356 and gave, in addition to the shares issued to General Spray Service, 100,000 warrants to purchase its own shares. In return General Spray Service gave Sprayfoil Industrial its own 6% debentures for \$176,882 and warrants to purchase 188,441 of its own Class "A" shares. In short, General Spray Service acquired its 90% interest in Sprayfoil for its debentures and warrants after the latter had divested itself of its most important asset. This arrangement was short-lived; by an agreement dated December 31, 1962 General Spray Service recovered its 6% debentures and the warrants for its Class "A" shares, together with 15,000 shares of Sprayfoil Industrial Corporation for its right to purchase that company's stock, and agreed to pay it \$91,000 with interest at 6%, \$10,000 in cash and \$5,000 monthly, beginning February 1, 1963. By the spring of 1963 General Spray Service was in trouble, its books and other records virtually non-existent, and Hoge's limitations well-recognized by his associates and particularly by his creditors.

Hoge Surrenders Control of General Spray Service Inc.

On February 21, 1963 Hoge had executed a proxy¹ appointing C. P. Morgan, Carman G. King and F. Reese Brown to vote all the shares registered in his name, pending the repayment of a loan made to him by Aurora Leasing Corporation, the curing of a default under the convertible debentures of General Spray Service Inc. bought by Annett & Co. for their customers and the payment of all loans made by Commodore Factors to General Spray Service and Sprayfoil Corporation. This loan of \$76,502 was made on the same day and may be observed as outstanding on July 30, 1965 in the amount of \$80,907 on the accounts receivable history of Aurora Leasing Corporation

⁸Exhibit 740.1.

¹Exhibit 2313.

OTHER MAJOR LOANS

shown on Table 20.² The explanation is that one of the conditions apparently imposed on February 21, 1963, illustrated by a letter from Hoge to General Spray Service,³ was the donation to the company by Hoge of \$75,000 of the amount borrowed by him from Aurora. The next significant date in its history was April 3, 1963 when Hoge wrote another formal letter to General Spray Service,⁴ reciting the fact that the auditors had found the company to be in "dire financial straits" and in need of further capital or financing. He undertook to convert 55,000 of his Class "B" shares, all 230,000 of which were being held by Aurora as security for its loan, into 55,000 Class "A" shares and to transfer the 175,000 remaining to General Spray Service on the understanding that it would assume his debt; finally he agreed to resign as an officer of the company, settle all outstanding commitments and surrender all his options. The transfer of the shares to the company and the conversion of Class "B" stock to Class "A" was not implemented, since by the terms of a revised proxy of April 3, 1963 the whole 230,000 Class "B" shares, with assignments executed in blank, were again entrusted to Morgan, King and Brown for voting purposes, subject to the same conditions, except that the loan to Aurora was thereafter to be payable by General Spray Service rather than Hoge. As at May 31, 1965 the only change in the shareholding was the issue of 25,000 Class "A" shares to a former dealer as settlement under an arrangement with the company's creditors.

F. Reese Brown, described by King as one of Annett & Co's customers in New York, who had been brought in to examine the affairs of General Spray Service, now became its president, but the summer of 1963 did nothing to restore its fortunes. By September 30, 1963 its contingent liability to Commodore Factors on the lease-purchase agreements assigned in respect of sales of trucks to operators had risen to \$509,629⁵ and its other loans received from that company, including those secured by accounts receivable and inventory assignments, operating loans and advances made to it in respect of Sprayfoil Corporation, amounted to \$642,683.⁶ An indication that Morgan was still wedded to the idea of the lawn spraying project, but under different auspices and by different methods, was provided by the incorporation of General Lawn Spray Limited in Ontario on July 26, 1963, with himself, E. W. Selkirk and Norman D. Hogg, a local agent of Sprayfoil Corporation, holding 100 shares each. This company, which will be referred to again, was to conduct its spraying operations directly, and not through distributors and franchised operators whose varying

²Exhibit 587.

³Exhibit 2314.

⁴Exhibit 2315.

⁵Exhibit 2321.

⁶Exhibit 2322.

capacities and financial responsibility had been sources of weakness in the American operation. On October 2, 1963 a special meeting of the board of directors of General Spray Service was held at the Fifth Avenue Hotel in New York, attended, according to its minutes,⁷ by C. Powell Morgan, Carman G. King, F. Reese Brown, Benjamin H. Oremland, George Poindexter and John J. Richardson. Brown repeated the observation made six months before that the company was in dire financial straits and that the largest single creditor was Commodore Factors. He announced a proposal by that company to acquire the shares of Sprayfoil Corporation, already pledged to it for \$250,000, representing money advanced by Commodore Factors for the acquisition of Sprayfoil Corporation by General Spray Service and moneys advanced to Francis H. Hoge Jr. for the account of the company during 1962 and 1963. This proposal was accepted, as was another made by Commodore Factors to purchase the company's rights to acquire stock in American Automation (Canada) Limited and American-Marsh Pumps (Canada) Limited for \$5,000 which had already been advanced. American-Marsh Pumps had been incorporated in Canada on March 28, 1951 as a private company and had thereafter engaged in the assembly and sale of fire trucks and industrial and irrigation pumps in its plant at Stratford, Ontario, one of its directors and vice-presidents having been Wilfrid P. Gregory until 1956; its entry into the Atlantic orbit will be described hereafter as will that of American Automation, incorporated in Ontario on March 2, 1962, and originally the agent for General Spray Service in Canada.

An Arrangement with Creditors: The General Spray Service Debentures

After these transactions the board of General Spray Service decided that the company should file a petition under Chapter XI of the Bankruptcy Act "and attempt to work out an arrangement with the creditors of the corporation". All that seems to have been retained by General Spray Service was an option to purchase 50% of the "Canadian operation" for \$50,000, exercisable until March 31, 1963. The company filed its petition on October 8, 1963 and by that date its liabilities, mostly to Commodore Factors, amounted to \$1,147,553 with an accumulated deficit of \$166,294.¹ Although at October 8, 1963 accounts receivable and inventories appeared sufficient to cover the loans secured by them, loans by Commodore Factors in an aggregate amount of \$223,105 for operating purposes for the Sprayfoil acquisition were unsecured. An arrangement with the company's creditors was eventually made under a plan dated January 6, 1964, and on terms

⁷Exhibit 2310.

¹Exhibit 2327.

which provided for the payment of unsecured claims which had been filed at a rate of 25¢ on the dollar with 2½ % of the claim to be paid in cash on March 20, 1964 and a further 2½ % on September 20, 1964, March 20, 1965 and September 20, 1965, the remaining 15% to be recovered by participation in the company's profits thereafter.² It has been seen in Chapter XIII³ in connection with the participation of Valley Farm and Enterprises that the 7% convertible debentures of General Spray Service were also compromised on this basis. By the end of March, 1965 payments of \$7,500 had been made on their compromised value of \$25,000⁴ and their subsequent history may be mentioned here. In February 1965 General Lawn Spray, which had shown signs of achieving some success in Ontario, needed additional financing and issued 10,000 shares at \$10,000 and \$200,000 of notes. The notes were to be sold for \$100,000 in cash and \$100,000 represented by the par value of these debentures. According to a letter from Irwin Singer of Solomon, Singer & Solway,⁵ reporting on the reorganization of the company to its president E. W. Selkirk dated July 15, 1965, supplementary letters patent had been obtained, dated March 18, 1965, increasing the authorized capital of the company by an additional 200,000 common shares without par value. Minutes had been drawn to reflect the subscription by Selkirk, Norman Hogg and C. P. Morgan for an additional 9,000 shares each to bring their individual shareholdings to 10,000. The letter continued as follows, setting forth the transaction with admirable clarity:

"Pursuant to your instructions, we did by letter dated February 10, 1965, correspond with Mrs. Mildred Morgan, Mrs. Kathleen Christie, Mr. Carman G. King and Mr. Clarence M. Fines, confirming their offer to purchase 7% Subordinated Notes of the Company and certain shares without par value of the Company.

At a meeting of the Board of Directors of the Company held on the 1st day of April, 1965, the Company authorized the creation of the 7% 10-year Subordinated Convertible Notes of the Company in the aggregate principal amount of \$250,000. At the same meeting, the following persons subscribed for shares without par value of the Company:

<i>Name of Subscriber</i>	<i>Number of Shares</i>
Mrs. Mildred Morgan	3,000
Mrs. Kathleen Christie	3,000
Carman G. King	3,000
Clarence M. Fines	1,000

and paid therefor the subscription price of \$1.00 per share.

²Exhibit 2320.

³pp. 853-4.

⁴Exhibit 2318.

⁵Exhibit 993.1.

We prepared and attended to the execution 7% 10-year Subordinated Convertible Notes (the "Notes") and pursuant to your instructions forwarded the same in the amounts and to the persons as follows:

<i>Name</i>	<i>Aggregate Principal Amount of Notes</i>
Mrs. Mildred Morgan	\$ 60,000
Mrs. Kathleen Christie	60,000
Carman G. King	60,000
Clarence M. Fines	20,000
Total	<u>\$200,000</u>

You advised us that the subscription price for the said Notes were to be paid, to the extent of 50% of the principal amount thereof, in cash, and the balance, in Debentures of General Spray Services Inc., due September 30th, 1970. You further advised us that the amount agreed to by the subscribers to be paid in cash had been paid directly to you or on your behalf. Mr. Carman King delivered to us what purports to be 7% Convertible Debentures of General Spray Services Inc. in the aggregate principal amount of \$70,000, all of which said Debentures are endorsed in blank for transfer. The said Debentures of General Spray Services Inc. are purportedly registered to the following persons:

<i>Name</i>	<i>Amount</i>
Mrs. Kathleen Christie	\$30,000
Mr. Carman G. King	30,000
Clarence M. Fines	10,000
Total	<u>\$70,000</u>

We advised you that we had as yet not received the \$30,000 aggregate principal amount of General Spray Services Inc. Debentures from Mrs. Mildred Morgan and you advised us that you would attend to obtaining the same on behalf of the Company. We are holding the said \$70,000 aggregate principal amount of General Spray Services Inc. Debentures in our files pending instructions from you with respect to the disposition thereof."

It will be noted that the \$30,000 of General Spray debentures, bought and paid for by Valley Farm and Enterprises and written off, as has been seen, to expense by that company, now appeared as belonging to Morgan's wife, pursuant to explicit instructions by him given to Carman King, as the latter testified. The balance of Mrs. Morgan's subscription was evidently met by a cheque drawn by her husband in favour of General Lawn Spray on his account at the Royal Bank of Canada in Freeport, Grand Bahama, dated April 1, 1965, for \$33,000.⁶ The transaction must be regarded as another example of fraud on Morgan's part, involving conversion of the funds of Valley Farm and Enterprises all

⁶Exhibit 3862.

of which were indirectly derived from Atlantic Acceptance. In connection with this reorganization Singer had written to General Spray Service on May 14, 1965,⁷ to the attention of Reese Brown in Yonkers, New York, advising it of the option to purchase the 7% convertible subordinated notes of General Lawn Spray in the principal amount of \$50,000 at par and 10,000 common shares of the Canadian company at \$1 per share, exercisable on or before May 31, 1965, and, in the event of such option being exercised, a further option to buy 10,000 shares at \$2.50 per share expiring on July 31. Had these options been exercised General Lawn Spray was bound to assume all contingent liabilities of General Spray Service to Commodore Factors arising out of assignments of accounts receivable and truck lease-purchase agreements with the American company's "Canadian dealers". General Spray Service did not avail itself of the options or apparently license the use of the Agi-Sprayer by General Lawn Spray which was part of the arrangement, but in effect Morgan had completed the process of transferring the undertaking of the crippled American company to its Ontario counterpart in which he and his associates held a dominant interest.

Good Money after Bad: The Turf Kings Solution

After General Spray Service had effected an arrangement with its creditors, a meeting of the directors of the company was held, according to the record,¹ on April 16, 1964 and was attended by C. P. Morgan, Everett Crosby, Carman King, F. Reese Brown, Benjamin H. Oremland and George Poindexter. Oremland informed the board that the company had been discharged from the proceedings under Chapter XI, and the meeting turned to the consideration of its future operations. All agreed that the system of franchising operators had been unsuccessful, and that General Spray should organize two new corporations, Turf Kings Inc. to employ operators and Turf Kings Leasing Inc. to own all trucks and lease them to Turf Kings Inc. for \$100 per month each; the stock of these two companies should be pledged to Commodore Factors as collateral security for all advances made "to the new operation". In addition, appropriate accounts receivable and inventory financing agreements would be executed in favour of Commodore Factors and chattel mortgages given on trucks, machinery and other equipment. The following quotation was undoubtedly an accurate statement of the position:

"The Chairman further stated to the meeting that in view of the present financial condition of the Corporation, it was highly dubious that any other person, firm or corporation would be willing to provide any financing to the Corporation."

⁷Exhibit 993.2.

¹Exhibit 2310.

According to Carman King this meeting actually occurred, although the decisions reported to have been taken had evidently already been made, since the new companies were incorporated in New York State on February 21, three shares in each case being subscribed for by General Spray Service. From this date until December 31, 1964 Turf Kings incurred an operating loss of \$125,523 and between January 1 and May 31, 1965 a further loss of \$37,060.² None the less Commodore Factors, from March 5, 1964 until the end of the year, made loans to Turf Kings amounting to \$224,069,³ a figure which by May 31, 1965 had increased to \$354,760. Turf Kings Leasing Inc. was virtually inoperative except to assume inventory loans and the obligations of General Spray Service already contracted for under truck lease-purchase agreements assigned to Commodore Factors in the aggregate sum of \$727,931, thus enabling Commodore Factors to show a reduction of receivables from General Spray Service by simply transferring the liability to a new debtor. In view of the sorry state of affairs at General Spray Service this attempt at resuscitation of Hoge's brain-child at the expense of Atlantic Acceptance appears to have been more than usually frivolous.

The shares of Sprayfoil Corporation which had been purchased by Commodore Factors were next sold by it to American Automation, pursuant to an agreement dated May 7, 1964,⁴ for \$255,000 in U.S. funds, to be paid by a promissory note bearing interest at 9% and secured by a pledge of the shares. The agreement was executed for Commodore Factors by C. P. Morgan and Barrie McFadden and for American Automation by Francis H. Hoge Jr. and one D. S. Chapman, also an officer of American-Marsh Pumps. Thus Commodore Factors was able to show a profit of \$5,000 on the sale, and American Automation took the first step to become a holding company for the shares of Sprayfoil and American-Marsh Pumps, the operations of which Morgan planned to centralize in Toronto where they were about to move when the disaster of June 14, 1965 overtook them all. In the meantime Hoge was still on the pay-roll and had transferred his activities to Sprayfoil Corporation in Minneapolis, where he set about attempting to liquidate its inventory by projected sales to India and Colombia which, had they been made, would have been uniformly unprofitable. The loans made to Sprayfoil by General Spray, with funds borrowed from Commodore Factors, amounted at December 31, 1964 to \$277,701 and from Commodore Factors direct to \$205,042, which, together with cash advances and expenses paid by General Spray up to the time of its bankruptcy proceedings in 1963, amounted in all to \$628,372. By July 12, 1965 Commodore Factors had lent direct to Sprayfoil an addi-

²Exhibit 2334.

³Exhibit 2331.

⁴Exhibit 891.1.

tional \$140,000, so that by then the total indebtedness of Sprayfoil to General Spray Service and Commodore Factors for funds derived from Atlantic Acceptance amounted to \$774,577.⁵ Walton, Wagman & Co. were appointed "independent auditors" for the 1963 audit of Sprayfoil and this firm's statement, together with figures culled from the books of Commodore Factors, General Spray Service and Sprayfoil Corporation, were analysed by Mr. Ross.⁶ From April 30, 1962 to December 31, 1964 it operated continuously at a loss which rose to \$479,281 in cash, while loans from General Spray Service and Commodore Factors mounted even faster to \$628,372. No security was given to General Spray Service for its share of the money lent. By May 31, 1965 the loans payable to Commodore Factors by General Spray, including the sums re-loaned to Sprayfoil and the indebtedness transferred to Turf Kings Leasing Inc., had reached a total of \$1,351,068; Turf Kings owed \$354,760 and the separate indebtedness of Sprayfoil Corporation to Commodore Factors, calculated at July 12, 1965, was \$351,247. The whole commitment of Atlantic funds was \$2,057,075.⁷

American-Marsh Pumps (Canada) Limited

As Commodore Factors had been the channel through which Atlantic money had been lavished on the spraying enterprise in the United States, so Commodore Sales Acceptance was called upon to finance the Canadian aspect of what Morgan planned, according to Carman King, as one massive operation. Evidence about the involvement of the comparatively venerable American-Marsh Pumps was given by Donald S. Chapman,¹ one of the original Canadian purchasers from the American owners of the company in 1957. After it got into financial difficulties the general manager, one McIlroy, sought the assistance of C. P. Morgan and at some point in 1960 the directors found the company owed Commodore Sales Acceptance some \$86,000 without any money to pay the debt, McIlroy having to some extent factored false invoices. After he had been dismissed and the company's engineer, T. F. Cramer, had become general manager, it made a proposal to its creditors, with W. L. Walton acting as trustee. From May 19, 1961, 3,795 shares, formerly held by Ajax Marsh Company Limited, out of 3,800 issued, were registered in the name of C. P. Morgan in trust, and the remainder were held by Cramer, Chapman, C. Leyda, H. R. Pickford and Harry Wagman. On September 9, 1961, according to the company's minute book² and as described in Chapman's evidence, C. P. Morgan in trust subscribed for an additional 6,200 shares for a

⁵Exhibit 2343.

⁶Exhibit 2345.

⁷Exhibit 2309.

¹Evidence Volume 43.

²Exhibit 204.

consideration of \$62,000 which was applied against the Commodore Sales Acceptance loan. On April 17, 1962 all the shares held in trust by Morgan, to the number of 9,995, were transferred to American Automation (Canada) and the minute book of that company³ records the purchase on April 4 of all the 10,000 outstanding shares of American-Marsh Pumps for \$5,000, subject to a call for a further \$57,000. The directors of American Automation attending this meeting were listed as Francis H. Hoge Jr., Carl M. Solomon, Michael J. Harte, Donald L. Lear and Irwin Singer, Solomon and Singer evidently representing the share interests of Morgan and Woolfrey. The stature of American Automation in this transaction is illustrated by an agreement, dated April 5, 1962,⁴ under which Commodore Sales Acceptance lent American Automation the \$5,000 required to be paid in cash, receiving a promissory note and the 10,000 shares of American-Marsh Pumps as collateral. But on July 23, 1962 the directors of American-Marsh Pumps, recorded as Hoge (the new president), Chapman, Lear and Solomon, four of whom had been directors of American Automation three months before, approved the transfer of 9,995 shares of the company from American Automation to General Spray Service, subject to the call of \$57,000 on 6,200 shares. Here again the price paid by General Spray was assumption of the liability of American Automation to Commodore Sales Acceptance of \$5,000 and the unpaid call on a portion of the shares. This change of ownership was of short duration, and the shares were sold back to American Automation by a decision of the board of General Spray, consisting of Poindexter, King, Brown, Oremland and Morgan, on April 22. Finally, in the following month the unpaid call of \$57,000 was met by a loan from Commodore Sales Acceptance to American Automation, the plan for General Spray Service to head the complex of companies was abandoned, and Morgan's choice fell on American Automation in which, incidentally, Hoge held the dominant interest.

American-Marsh Pumps, which had secured its first loan from Commodore Sales Acceptance on November 6, 1959,⁵ was entirely dependent on that company for funds, and all the payments made to creditors in early 1961 had been advanced by it. On November 30, 1961 loans from Commodore Sales Acceptance against accounts receivable, and operating loans generally, amounted to \$206,201, and had risen by July 12, 1965 to \$709,724. These were secured by a chattel mortgage on machinery and a first mortgage on the company's Stratford property, both for \$70,000, a floating charge debenture for \$200,000 and an assignment of book debts. But the operating position⁶ showed

³Exhibit 612.

⁴Exhibit 2348.

⁵Exhibit 2349.

⁶Exhibit 2351.

OTHER MAJOR LOANS

very low gross profits on sales throughout the period and selling, administrative and financial expense were more than sufficient to cause net operating losses. By November 30, 1964 the deficit had grown to \$467,494 and the loans from Commodore Sales Acceptance to \$588,946,⁷ compared with tangible assets of \$380,552. As in all cases where companies had to rely exclusively for their financing on Commodore Sales Acceptance or Commodore Factors, the charges were particularly galling, and Donald S. Chapman, who succeeded Cramer as general manager of the company and was also a director of American Automation, "in lieu of salary" as he said, spoke with feeling on the subject in his evidence before the Commission. He referred to the period following the successful proposal of American-Marsh Pumps to its creditors:⁸

"Q. What about the efforts of the company to get back on its feet again?

A. Mr. Kraemer (Cramer) took over as General Manager and I continued on in the Sales part of the company and the company was steadily coming back until the collapse of Atlantic, although we paid fantastic amounts of interest on all the money we used.

We were paying interest on top of interest in most cases. The last year that the company operated, I think we paid in excess of \$50,000 worth of interest. That was on less than \$600,000 worth of sales. We still just about broke even.

Q. Did you ever have an opportunity to do any calculation to calculate the effective rate of interest your company was paying from time to time to Commodore Sales Acceptance Limited?

A. Mr. Kraemer (Cramer) went to Henriksen Limited as their president in 1963. He was offered the presidency and figured we would never get out from under the heavy burden we were carrying.

So I took over at that point as General Manager and several times I figured interest. After it got over about thirty-eight or thirty-nine per cent, I gave up.

THE COMMISSIONER: What do you mean it got over that figure?

A. The way Mr. Woolfrey ran the notes and the supply of money, often we would find we were paying interest on top of interest.

We would get so much money to operate the company and that was at a fixed rate of interest, around twenty-one or twenty-two per cent in most cases.

Then in one particular case we were just discussing, General Spray Corporation or General Lawn Spray Limited, we built truck bodies for them and we had to supply the trucks to them. We didn't get paid for them. Then we had to get more money to replace what we supplied General Spray. Then we had to pay interest on that amount. This

⁷Exhibit 2350.

⁸Evidence Volume 43, pp. 5959-61:

happened in several different areas. Several times we got money from Mr. Woolfrey. We signed notes to cover it.

Q. In effect, Mr. Chapman was Commodore Sales Acceptance Limited the bank for American Marsh Pumps (Canada) Limited?

A. Yes.

Q. You would rely on Commodore Sales to supply you with funds for your operating expenses?

A. Any money that the company required came directly from Commodore."

He went on to say that the company was allowed to keep about \$1,000 in the bank, that its operations were under constant scrutiny by Mr. Fruitman of the Walton, Wagman & Co. accounting firm and that, as at November 30, 1964, out of \$104,794 shown as "selling, administration and financial expenses" some \$56,000 consisted of finance charges. None the less, by the end of 1964 he felt that the company had definitely turned the corner and was selling more fire apparatus than any other in the business except one.

American Automation (Canada) Limited

American Automation (Canada) was, said Chapman, just a "paper company" located in the office of Solomon & Singer. As already noted, it was originally agent for General Spray Service in Canada and subsequently held shares of Sprayfoil Corporation and American-Marsh Pumps. The shareholders after incorporation were F. H. Hoge, Jr., Carl M. Solomon, Irwin Singer, M. J. Harte, and D. L. Lear. Ninety-five of the 100 issued shares were registered in the name of Hoge, the other shareholders holding one share each in trust for him. Subsequently Singer's share was transferred to Cramer and Harte's to Chapman, while those of Lear and Cramer went to Hoge.¹ In the files of Commodore Sales Acceptance two declarations of trust were found, dated April 15 with the year left blank in one, probably executed in 1963, wherein Hoge acknowledged that he held 30 common shares in trust for C. Powell Morgan² and five for A. G. Woolfrey.³ Share certificates were actually issued to the beneficiaries in these denominations but were found cancelled and described as issued in error. On May 7, 1964 by an agreement between Hoge and Commodore Factors⁴ all 100 shares of American Automation were pledged to the latter as collateral security for money advanced for purchase of the shares of Sprayfoil Corporation, and this debt was transferred from Commodore Factors to Commodore Sales Acceptance on October 1, 1964. Commodore Sales Acceptance lent

¹Exhibit 2352.

²Exhibit 2302.1.

³Exhibit 2302.2.

⁴Exhibit 2353.

OTHER MAJOR LOANS

\$459,594 to American Automation, paper company or not, only \$32,624 of which had been repaid by July 12, 1965. This amount consisted principally of the \$255,000 in U.S. funds lent for the purchase of the Sprayfoil shares and \$62,000 to buy back the shares of American-Marsh Pumps from General Spray Service. These shares were assigned to Commodore Factors and there is no evidence that they were subsequently pledged with Commodore Sales Acceptance which had made the loans.

General Lawn Spray Limited

General Lawn Spray had, by the spring of 1963, got off to a good start through a contract with the T. Eaton Company in Toronto to supply its lawn spraying service to that company's many thousand customers in the area. The franchise-holder was originally the Halliday Fuel Oil Company, which proved to be unwilling to make sufficient investment in trucks and equipment to supply the service to a much larger number of customers than had ever been contemplated, and the president of General Lawn Spray, E. W. Selkirk, who testified to the Commission,¹ had to make emergency arrangements, which included his own services as a truck-driver, in the middle of the season. The shortage of properly equipped vehicles was the company's chief problem; this was alleviated in the 1964 season by importing repossessed vehicles from General Spray Service at Katonah, New York and new vehicles assembled by American-Marsh Pumps; for the 1964 season the company deployed 30 vehicles for greatly expanded operations throughout southern Ontario. Selkirk, who, unlike Chapman, was highly regarded by A. G. Woolfrey, was evidently an energetic manager but was unable to organize the book-keeping engendered by all this activity, so that the company's records and books of account were of little assistance to the Commission's investigators. Of the 1965 season, which was abruptly terminated by failure of Commodore Sales Acceptance to meet General Lawn Spray's pay-roll for the week of the Atlantic default, Selkirk said: "The flood of work coming from the 1st of April through to the end June was something which we hadn't, by the wildest stretch of our imaginations, counted on at all." In spite of repayments between January 1 and June 17, 1965 of \$155,644 the balance due to Commodore Sales Acceptance on June 17 amounted to \$689,253.

Summary of Loans and Loss

The loans payable by the three Canadian companies, American-Marsh Pumps and American Automation at July 12, 1965, and General Lawn Spray at June 17, amounted in all to \$1,853,984 and this, added

¹Evidence Volume 43.

to the total due from the American companies, General Spray Service, Turf Kings, Turf Kings Leasing and Sprayfoil Corporation, produced a combined total of \$3,911,059. The Clarkson Company, which acted as receiver for all the companies within its jurisdiction and which had prudently accelerated the movement of the assets of Sprayfoil Corporation from Minneapolis to Toronto, was in a unique position to estimate the losses of Atlantic Acceptance funds, and, indeed, had liquidated a substantial portion of the assets of Sprayfoil Corporation and American-Marsh Pumps by public auction by the time that Mr. Ross's evidence was given. His summary of the loans made by the two Atlantic subsidiaries, together with an estimate of recovery and loss, is appended as entered in evidence.¹

**GENERAL SPRAY SERVICE, INC.
AND RELATED COMPANIES**

Summary of Loans Payable to Atlantic Group as at Approximate
Dates Major New Loans Ceased to Be Made
as at Dates Falling Between May 31, 1965 and July 12, 1965
per Records of Commodore Factors Limited and Commodore Sales
Acceptance Limited and of Approximate Loss Thereon

	<u>Loans payable as at</u>	<u>Amount of loans payable</u>	<u>Estimated recovery thereon</u>	<u>Appx. loss to Atlantic Group</u>
Loans payable to Commodore Factors Limited by:				
General Spray Service, Inc.	May 31, 1965	\$1,351,068	\$40,000	\$1,665,828
Turf Kings, Inc.	May 31, 1965	354,760		
Turf Kings Leasing, Inc.	May 31, 1965			
Sprayfoil Corporation.	July 12, 1965	351,247	56,000	295,247
		<u>\$2,057,075</u>	<u>\$96,000</u>	<u>\$1,961,075</u>
Loans payable to Commodore Sales Acceptance Limited by:				
American-Marsh Pumps (Canada)				
Ltd.	July 12, 1965	\$ 709,724	\$ 93,131	\$ 616,593
American Automation (Canada)				
Limited.	July 12, 1965	455,007		455,007
General Lawn Spray Limited. ...	June 17, 1965	689,253	132,000	557,253
		<u>\$1,853,984</u>	<u>\$225,131</u>	<u>\$1,628,853</u>
		<u>\$3,911,059</u>	<u>\$321,131</u>	<u>\$3,589,928</u>

A characteristic failure of Solomon & Singer to register the floating charge debenture and chattel mortgage, taken as security by Commodore Sales Acceptance from American-Marsh Pumps, reduced the expected recovery in this quarter by some \$21,000.² It should be recorded, in fairness to the Clarkson Company, that strenuous efforts were made to sell these companies as going concerns, pursuant to enthusiastic estimates

¹Exhibit 2366.

²Exhibit 5124.

OTHER MAJOR LOANS

of the results of current negotiations by Francis H. Hoge Jr. who had committed them to unprofitable export contracts. In the case of General Lawn Spray the Clarkson Company was appointed receiver and manager under a \$400,000 debenture held by Commodore Sales Acceptance. Its comments on the accounting methods of this company were disparaging enough, and its report indicates that many of the accounts receivable assigned to Commodore Sales Acceptance were invoiced in anticipation of work to be done weeks later; a large proportion of these were judged to be uncollectible. Commodore Sales Acceptance had been making advances to General Lawn Spray at the rate of some \$5,000 per week to underwrite operating losses. Here again attempts were made to sell the company as a going concern and Selkirk made several efforts to acquire it on terms as to payment which were not considered acceptable. At an auction held on November 24, 1965 the net proceeds amounted to \$123,303.67. Selkirk in the meantime had set up a new company called Turf Kings Limited, with himself as president, and was alleged to have attempted to collect for its benefit accounts receivable from former customers of General Lawn Spray. The American group of companies, consisting of General Spray Service, Turf Kings and Turf Kings Leasing, were placed in bankruptcy in the State of New York and, as can be seen, only a nominal recovery of loans made by Commodore Factors is expected.

Looking at this extraordinary outpouring of nearly \$4,000,000 in loans from which less than 10% can conceivably be recovered, there are recognizable features common to C. P. Morgan's other ventures in "secondary banking". Francis H. Hoge Jr. was not available as a witness before the Commission, but his particular blend of optimism and aggressiveness clearly appealed to Morgan's weakness for gambling, just as his companies provided an opportunity for indulging Morgan's determination to take a personal position in enterprises which his companies were financing and in conflict with his fiduciary obligations. Hoge's basic idea, which appealed so strongly to Morgan and indeed to Carman King, may at this point of vantage in time be considered too fragile for the type of organization which developed from it. The spraying business is generally regarded as highly competitive, and such gross profits as were achieved by the companies considered were incapable of sustaining the heavy finance charges piled up by Commodore Sales Acceptance and Commodore Factors.

Personal Interest of A. T. Christie

One aspect of these disastrous ventures, most of which were prematurely involved in ruin by the collapse of Atlantic Acceptance, remains to be recorded. Counsel for the Commission were anxious to question C. P. Morgan about his private investments in them but the opportunity

never came. It did however materialize in the case of Alan T. Christie who, as a director of Atlantic Acceptance, Commodore Sales Acceptance and Commodore Factors, was naturally asked to comment on the investments made in the name of his wife, and admittedly by his direction, in General Spray Service and General Lawn Spray to which the Commodore companies were making large and improvident loans. The evidence was given on December 15, 1966:¹

“Q. . . . There has been evidence before the Commission generally to the effect that on or about the 30th November, 1962, some interests were taken in General Spray Services, those being Mrs. Christie, to the extent of \$30,000; Valley Farm & Enterprises to the extent of \$30,000; and Mr. Carman King and Mr. Clarence M. Fines as well; is that correct?

A. Yes, that is correct.

Q. Could you assist us as to how you came to be in this business?

A. Mr. King suggested investment in this company, which he had done some work on, and he supplied me with the so-called short form supplied to the Securities Exchange Commission of a company that already had filed and had raised some money and was publicly traded in the United States. It was in a business which interested me in that I had seen, in the community in which I lived, a number of profitable companies of this sort who sprayed lawns and trees and things of this sort, and which I have since learned were not as generally accepted here in some areas as they are there, or perhaps they were better administered. But it was proposed that this investment be made, which had an equity addition to it, and I made the investment with the idea of making some money from it.

Q. Did you discuss the matter with Mr. Morgan?

A. No.

Q. Did you know at that time that Mr. Morgan, through Valley Farm & Enterprises, had an interest which was equal to that of yourself? I will say, yourself, meaning . . .

A. I knew this company, Valley Farm, because it was in the documents as we signed them and when I asked about them I understood it was some company that Mr. Morgan had bought into—the company—but I had no knowledge what it was. I don’t know even now what it was.

Q. Who told you about Valley Farm & Enterprises?

A. Mr. King. He explained what it was as I have told you, yes.

Q. What did he tell you again, please?

A. That it was a company that Morgan had bought in. Whether it was one that he had an interest in, or whether he knew people that were interested in it, I couldn’t confirm that.

¹Evidence Volume 91, pp. 12368-73.

OTHER MAJOR LOANS

Q. Did you enquire at the time as to whether it was Mr. Morgan's company?

A. No. Had it been, it would not have probably changed my decision, because I thought it was a good business risk and the money was going in in subordinated form and the money was 'risk money'.

Q. Yes. When did you understand first that Commodore Factors Limited was lending money to General Spray Services?

A. Well, I knew—I never knew it was specifically Factors, but I knew quite early on that Atlantic was lending money in some fashion senior to our money.

Q. Yes?

A. And it is my belief that this was a company which could develop business for Atlantic.

Q. The company had certain subsidiaries, did it not? Turf King Incorporated and Sprayfoil Corporation?

A. I think so, although I never looked into those thoroughly as to how the corporate structure was set up, but this Sprayfoil one was one I believe that enjoyed a French patent, that was used in farm spraying. This I gathered from the filing with the Securities Exchange Commission, and it included balance sheets audited by Price, Waterhouse & Company and complete information as required by the S.E.C. in the so-called short form.

Q. The operating results of the company were in fact not satisfactory. Is that not correct?

A. That is the way it turned out, yes. Although, the figures when we went into it did not give that indication and there was trading over the counter in securities of this company prior to our doing so.

Q. By the 8th of October, 1963, according to the evidence before the Commission, proceedings in bankruptcy had been taken. Approximately, comparable to our proposal in bankruptcy, as we have it here?

A. I don't understand the technical details, but I think they filed under a certain numbered section 10B.

Q. Yes. In any event . . .

A. It is the voluntary re-organization form, rather than the compulsory.

Q. The evidence we have had is to the effect that that occurred on the 8th of October, 1963. Would that substantially be in agreement with your recollection?

A. I am prepared to accept your dates. This was my first experience of any company that had ever been in this position. It was entirely new to me and I wrote it off as being an investment that didn't turn out well.

Q. Were you concerned about the size to which the Commodore Factors loans or the Atlantic loans had grown?

A. To this company?

Q. Yes.

A. Outside of that piece of paper, I never knew anything about the specific size.

Q. When the bankruptcy proceedings were taken, did you make enquiry to ascertain the degree to which Atlantic was affected, if it was affected at all?

A. On this point I had a—at a meeting—I asked Mr. Morgan really more, I mean, what this proceeding meant, and as I said, I have never had any experience in it and it was my impression from him that this was a step that was taken to protect Atlantic in that they were operating under this form and which meant they could operate and Atlantic's advances were still secured and recoverable.

Q. Did you ask him how much money Atlantic had involved in the matter?

A. I can't remember that I did."

Further questions were put to Christie as to his knowledge of the size of the loans made to General Spray Service, Sprayfoil Corporation and Turf Kings, amounting to approximately \$1,725,000 at December 31, 1964, and as to whether he was aware of loans of that magnitude:²

"A. I was not, and I doubt if any of the directors were aware of those loans. I am sure they were not.

Q. I was wondering if you would not be aware of it by reason of Mrs. Christie having a significant interest in the company?

A. When the receivership took place so far as we were concerned, we wrote it off and were not pursuing what happened to it.

Q. When the discussion took place of which you made a note before the Board of Directors, did you call to their attention the fact that there was an interest in that company in your family?

A. I don't recall that I did.

Q. On reflection, do you now consider that it would have been better advised had you done so?

A. Well, no. If you ask me is there any reason why I should have I don't know of it, but perhaps there was.

Q. Perhaps you could expand on that, Mr. Christie. Why is it the position that there is no reason to think that you should mention it to these directors?

A. Well, I wasn't conscious of an obligation to report it to them. If there was, then I was remiss.

²Evidence Volume 91, pp. 12374-7.

OTHER MAJOR LOANS

Q. Did you think you were under any obligation to raise with your fellow directors the question of whether or not Mr. Morgan, through Valley Farm, might indirectly have an interest?

A. No. Of course, bear in mind that we had no knowledge of these sizeable loans. The loans of the magnitude you are talking of.

THE COMMISSIONER: Do I take it from that, Mr. Christie, that you had some knowledge of certain loans but not loans . . .

A. The only one that I speak of specifically was the one that was on that sheet of paper that I recall.

THE COMMISSIONER: Yes.

MR. SHEPHERD: Mr. Morgan, at all events, put the amount at \$600,000. Is that correct?

A. It appears as though he either said that a hundred thousand had been paid off or was being paid off. As you see, there is a note there. It is reduced to 500,000.

Q. You were aware, through Mr. King, that Mr. Morgan had introduced Valley Farm and I think you said that you didn't know whether this indicated that he had any interest in Valley Farm or not?

A. That is right. Had he had a position in it I would not have thought differently probably because I did not think that his actions were motivated by a personal interest of his.

Q. I don't wish to pursue the matter any further than necessary, Mr. Christie, but were you not concerned about Mr. Morgan being the person who decided on these loans whatever amount they were, the company being then subject to bankruptcy proceedings and there being some ground for believing Mr. Morgan might have an interest in the equity of the company? You were, were you not, then sufficiently concerned that you wanted to call that to the attention of your directors?

A. No, I was not. But I conceive from your thoughts and what has happened since and its size, we now find out of the advances that have been made apparently unwisely, that it would have been preferable had I done so. It would have been preferable had I never invested in the company."

Christie's answer that after the "receivership" of General Spray Service he and his wife wrote their investment off, "and were not pursuing what happened to it," was difficult to reconcile with the subsequent investment in General Lawn Spray about which counsel was bound to inquire.³

"Q. Then, in the early months of 1965, according to the evidence before the Commission, Mrs. Christie and Mrs. Morgan made an investment of \$30,000 each and Mrs. Christie clearly paid her money in a company called General Lawn Spray Limited, the Canadian company?

A. That is correct.

³Evidence Volume 91, pp. 12378-81.

Q. Was this company doing substantially the same business?

A. Yes, and it was my understanding that they bought the properties and assets up here and believed that they could work the whole enterprise out up here at that time or perhaps even before that, they had enlisted in an association with Eaton's to sponsor this growth and this money, in my opinion, was to add equity into the company to strengthen Atlantic's position. I didn't realize and I found out afterwards that it just disappeared almost immediately, but it was equity behind Atlantic's position and we did not know, of course, the size of the loans that were in it.

Q. Now, when Mrs. Morgan showed up as a shareholder in that company, I suppose that at least from that time on, you were in no doubt about Mr. Morgan's interest in it?

A. Yes, quite so.

Q. Yes?

A. I was under the misguided impression, apparently, that Mr. Morgan was prepared to put means of his own to strengthen companies in which Atlantic had loaned money and by putting equity behind them would strengthen their credit.

Q. Yes?

A. I was not putting a motivation worse than that.

Q. Were you aware of the size of the loans involved by Commodore Sales Acceptance to this company? Perhaps I could put them to you the end of—31st December, 1964, Commodore Sales records an indebtedness to it of \$434,471 from General Lawn Spray, and at 17th June, 1965, the records indicate a loan outstanding of \$689,252, were you aware of amounts in that order?

A. No, I was not aware of those. The only thing that was supplied to us at that time by the president of General Lawn Spray was a rather reassuring and bright analysis for the outlook of the company and showing forecasts of their operations which—of which I have records.

Q. Did you feel any concern about Mr. Morgan or Mrs. Morgan having an interest in the company when Mr. Morgan was the person who decided what loans would be made and on what security?

A. No. It was as inconceivable to me as it was to the other directors. I think that the motivations for loans were other than good business judgment.

Q. I don't want to press the matter, but were you not concerned about whether that was obviously so once you became aware that Mr. Morgan had indirectly some interest in one of the borrowers?

A. Well, you mean the Valley one?

Q. No. I meant Mrs. Morgan's interest in General Lawn Spray?

OTHER MAJOR LOANS

A. No. I still have the same opinion. I felt that he made it quite open, he didn't hide the fact that it was Mrs. Morgan.

Q. Yes?

A. And I felt that he must have realized that he was putting money at risk behind Atlantic if this was going to help to make Atlantic's position stronger, this was a consideration that he was making.

Q. Did you not consider, though, that he ought to have at least told the directors about it since he was the chief operating officer who was making the loans?

A. With hindsight, I would say, yes. He should have, but it never crossed my mind. I am not certain that it was not known, it was not known, formally known in the records. I realize . . .

Q. I can only put it to you that we were informed that the other directors did not in fact know this?

A. Yes. I think that is quite possible."

While I am satisfied that Mr. Christie gave his evidence with candour it wears a negligent and implausible aspect in two particulars. One would have thought that the maxim "once bitten twice shy" would have governed the conduct of any ordinary investor and that the investment of additional funds of Mrs. Christie, after the lamentable performance of General Spray Service, could not have been made without considerable and close calculation. Moreover justification of Morgan's and, indeed, Christie's position of "putting money at risk behind Atlantic" as a means of sustaining the Atlantic investment, an explanation also heard by the Commission from Wilfrid P. Gregory in a different context, does little to dispel the impression that Christie, like Morgan, and indeed like Gregory in similar circumstances, was consciously putting himself in a position to derive personal benefit from the stimulus administered by Atlantic loans to the company in which his wife's investment was made. Although he put the best face possible on these transactions, it is certain that at the time his evidence was given he did not feel it was a particularly good one. The disadvantages to Atlantic Acceptance of having one of its leading directors in such a position far outweighed any support, real or fancied, that his personal investment might have offered.

2

Arcan Corporation Limited

The selection of Arcan Corporation Limited, among the many concerns to which the funds of Atlantic Acceptance were lent through subsidiary and related companies, for particular examination is not owing

to the size of the loans outstanding at the time of the Atlantic collapse but rather to its significance as a further illustration of the financial activities of C. P. Morgan and the need to place in its proper setting the position of one Gerald Groship, of whom much will be said in the course of this chapter, in connection with very large loans to companies other than Arcan Corporation and correspondingly large losses of Atlantic funds. Arcan Corporation provides a good example of the vicissitudes of a company under the existing system of incorporation, leading a mysterious and perpetual corporate life in spite of change of name, function and human direction. It was incorporated in Ontario on August 27, 1937 as Cub Aircraft Corporation Limited and originally operated a small flying school and aircraft retail business in Hamilton. During the war it produced parts for military aircraft and, in company with many other concerns engaged in war contract work, experienced difficulty in maintaining production on a comparable scale and with expanded plant in the post-war years. A merger with a small manufacturer of automobile radios, General Radionics Limited, occurred in 1949 when the company changed its name to Transvision-Television (Canada) Limited and began assembling television sets under the "Transvision" brand name. On the outbreak of the Korean War its aircraft division was resuscitated and entered the field of metal fabricating which gradually replaced its electronics business. Its name was changed to Arcan Corporation at August 21, 1953 and in 1954 its Hamilton works commenced manufacturing materials-handling equipment; this business subsequently was entrusted to a subsidiary company called Arcan Eastern Limited, incorporated in Ontario on April 1, 1957,¹ with the manufacture of other metal products. When its name was changed Arcan Corporation's common shares were listed on the Toronto Stock Exchange, trading in 1953 between prices of \$1 and \$1.55. With the approval of the exchange, on May 25, 1959 Arcan Corporation, which had at this point become a holding company only, issued an additional 277,703 shares at \$4 per share. Of these 127,423 were subscribed for by Eila Investments Limited, the shares of which were beneficially owned by one Donald Phillip Owen, a director of Arcan since January of that year. The arrival of Owen on the scene and his appointment as a director were ill-omened. According to his own testimony before the Commission on September 15, 1966,² he began to buy shares of Arcan in 1957, and in 1959 purchased a majority of those belonging to the company's president, Robert A. Armstrong, C.A. On March 30 Rennie A. Goodfellow and Gerald Groship were elected to the board and on May 25 Owen became vice-president.³ Goodfellow's

¹Exhibit 4823.

²Evidence Volume 58.

³Exhibit 144.

OTHER MAJOR LOANS

presence at the board may be explained by the fact that Barrett, Goodfellow & Co. made a short-term loan of \$350,000 to Arcan, outstanding from March 11 to May 25, 1959, although he remained there until 1961.

Arcan Buys Control of Bon Ami Limited

On March 19, 1959 Arcan Corporation purchased from the Bon Ami Company, a Delaware corporation manufacturing household cleansers, 3,000 of the 5,000 issued shares of Bon Ami Limited, its Canadian subsidiary, paying \$50,000 in cash and delivering 6% debentures to secure the balance of \$100,000 due for payment in 1969. This acquisition, and the rumours of others assiduously circulated by Owen, who had acquired by his own calculation some 55% of Arcan's stock, carried the price of its shares in July 1959 to over \$8 on the Toronto Stock Exchange. From this level it fell almost overnight to \$1.50 per share and the stock was removed from the trading list on July 21. It was never thereafter restored and on May 2, 1962 the issue was finally suspended, its trading on the unlisted market having in the meantime been at prices, generally speaking, below \$1. After complaint by a shareholder the Ontario Securities Commission undertook an investigation and the report of the Chairman, Mr. O. E. Lennox, dated May 13, 1960, found that the market fluctuation was caused by misrepresentations on the part of Owen to an anonymous group, evidently located in New York, which attempted to maintain a market by buying shares from Eila Investments. It is clear from the report that the Chairman considered this group, which had instigated but otherwise failed to assist the investigation, was almost equally culpable.¹ The real sufferers were, of course, the shareholders who for a time had to put up with Owen's control of their discredited company, relinquished in 1962 to other masters.

Gerald Groship

Groship had been employed for eight years by Oshawa Wholesale Limited before leaving this company to join Arcan Corporation and had been its director of merchandising. He said in his evidence before the Commission,¹ given on May 31, 1966, that his change of employment was a result of a neighbourhood acquaintance with Owen. He brought with him Arcan's most recent acquisition, a soft goods rack distribution system for "supermarkets" and other retail outlets, the development of which was conducted by a new subsidiary company called the House of Arcan Limited, incorporated in Ontario on March 16, 1959.² The first

¹Ontario Securities Commission Bulletin May 1960.

²Evidence Volume 40.

³Exhibit 2531.

year's operation of this company proved to be unprofitable³ and its inventory was sold off in 1960; but in the meantime Groship, who had been president of the company and also of Bon Ami Limited, had departed. In the course of ten weeks he had alarmed the Arcan directors by lavish expenditures which included the payment to himself of salary at the rate of \$50,000 a year, evidently without benefit of a contract or any other authorization. Between March 9 and June 30, 1959 the House of Arcan lost \$13,000 on operations, acquired inventory valued at \$395,000, accounts payable of approximately \$116,000 and owed its parent company \$410,000. It was providentially discovered that Groship owned no shares of Arcan Corporation and thus was disqualified as a director. After his resignation as general manager of the House of Arcan and Bon Ami he turned, in the autumn of 1959, to a millinery retail business which he described as being more modest than his previous activities, but, as will be seen, became of some consequence in the affairs of Atlantic Acceptance Corporation. Thus for a season he was absent from the deliberations of Arcan Corporation.

The Struggle for Control between Owen and Morgan

In the climactic month of July of 1959 Arcan acquired for \$35,000 all the shares of Charcoal Supply & Sales of Ontario Limited, a company owning an obsolete plant at South River, Ontario and engaged in the manufacture and sale of charcoal under the brand name of "Beaver."¹ In 1961 Arcan next acquired a 71.2% interest in Selectra Industries Limited of Toronto which manufactured portable refrigerators and on May 4 of that year became a public company. Selectra wholly owned Pneuma-Serve Limited, a company manufacturing, among other things, machines which automatically sorted screws and nuts. In the following year Selectra acquired a controlling interest in Westworld Artists Productions Inc. of New York which had developed a process for producing cartoon films and had enjoyed little success in marketing its product. About the same time Arcan disposed of its manufacturing subsidiary in Hamilton, Arcan Eastern Limited, to the Gurney Scale Company and announced that henceforth it would confine its operations to the field of "consumer goods."²

Obscurity surrounds the origin of the relationship between D. P. Owen and C. P. Morgan. The former testified that in the autumn of 1957 he made a personal loan of \$10,000 to Morgan which was repaid, and he admitted that Morgan had shown an interest in mining stock promotions for which Owen had acquired some notoriety. It would

³Exhibit 146.

¹Exhibit 144.

²Exhibit 148.

OTHER MAJOR LOANS

appear that in 1961 Morgan claimed to be a substantial shareholder of the stock of Arcan Corporation and suggested representation on the board of directors, but, since he proposed a nominee and was not willing to serve himself, he was not appointed. Owen recalled that in the spring of 1962 Groship had come to him with the information that Morgan was anxious to obtain control of Arcan and that he had told Groship he was not interested in selling stock. Whatever the exact sequence of events may have been, on July 27 Morgan sent a handwritten note to Owen reading:³

“Dear Phil—

This will advise that Yarrum Investments of which Bill Walton is the President has taken me out of the Arcan & Dale pictures.
He will no doubt be in touch with you.

Powell”

This was interpreted by Owen as a threat of hostile action at Arcan's next annual meeting on September 25. Accordingly he and R. A. Armstrong determined to exercise options granted to them, according to the minute book, on May 14 to purchase 285,000 shares for themselves and selected employees of the company at 35¢ per share. The details of how this purchase was made, and its reputed connection with the sale of Arcan Eastern shares to the Gurney Scale Company, are not relevant to the main purpose of this narrative which is to illustrate the involvement of Atlantic Acceptance Corporation, but the issue of the shares was sufficient to defeat an attempt by W. L. Walton to elect a board of directors of his own nomination on September 25, the recorded vote being 487,858 for the Armstrong-Owen group of shareholders against 234,196 for what was described as the Walton-Noble group.⁴ In any event a settlement was reached with Morgan and his associates which involved the purchase of 100,000 shares of Arcan stock from Owen by Morgan at a price of \$1 per share, the resignation of Owen and Armstrong and their nominees from Arcan's board, the inclusion of Groship in the new directorate and the exclusion of Walton.⁵ Owen drove a hard bargain, as indicated by paragraph 7 of an agreement between him, Morgan and Groship, dated September 20, 1962:⁶

“Morgan and Groship agree to secure for Owen at the time of Owen's resignation from the board of directors of Arcan a long-term contract in favour of a Company to be nominated by Eila Investments Limited and such contract shall contain the Canadian national distribution rights for all the products and sales of Bon Ami, Limited, Star Products,

³Exhibit 3013.

⁴Exhibit 1869.

⁵Exhibits 1869.2 and 1869.3.

⁶Exhibit 1869.2.

Duncan Products and Charcoal Supply & Sales of Ontario Limited, at a commission rate of 6% on gross sales and further to secure for Eila Investments Limited or its assignee from Bon Ami, Limited and Charcoal Supply & Sales of Ontario Limited an irrevocable fee from each of \$12,500.00 per annum for a period of five (5) years from the date of such arrangement being effective, and such effective date shall not be later than one month from the date of Owen's resignation as hereinbefore described."

This undertaking hung like the albatross around the neck of Arcan Corporation for the next two and a half years, imposing in particular a strain on the resources of Bon Ami Limited, its only profitable subsidiary. The welfare of this company was a source of concern to Standard International Corporation Inc. which had bought the assets of the American Bon Ami Company, including the 40% minority interest in the Canadian concern. Strange as it may seem, this purchase was made apparently without the principals of Standard International knowing of the sale of 60% of the stock of the Canadian company by its American parent to Arcan. Although the Bon Ami Company had evidently fallen on evil days after having been a household word in North America, the name of its product was still one to conjure with; without control of the Canadian subsidiary, with its manufacturing and selling rights, the shares of Arcan Corporation were worthless.

The part played by Valley Farm and Enterprises Limited in the affairs of this company has already been referred to in Chapter XIII and the use of the "directors loan payable" account for reimbursing C. P. Morgan for a loan of \$10,000 made to Westworld Artists Productions in August 1962, and for creating the credit in favour of Morgan, Walton and Wagman with part of which Morgan was able to find \$100,000 of Atlantic funds for the purchase of Owen's shares of Arcan, previously described.⁷ A short review, with more emphasis on the Arcan end of the transaction, is desirable. On September 24, 1962 Walton and Wagman borrowed \$25,000 from the King and Yonge Streets branch of the Toronto-Dominion Bank at Toronto on a demand promissory note.⁸ On the following day these funds were deposited first in Walton's account in the King and Yonge Streets branch⁹ and forthwith transferred into Morgan's account at the bank's branch at 25 Adelaide Street West,¹⁰ enabling him to write a cheque in favour of Owen for \$25,000 which was deposited in the joint account of Donald Phillip and Eila Owen at the main branch of the Canadian Imperial Bank of Commerce on October 1.¹¹ Walton and Wagman's loan was repaid to

⁷p. 838.

⁸Exhibit 1263.

⁹Exhibit 2992.

¹⁰Exhibit 2994.

¹¹Exhibit 2998.

OTHER MAJOR LOANS

the Toronto-Dominion Bank on October 26 by a cheque of Valley Farm and Enterprises drawn on its account in the same branch of the Canadian Imperial Bank of Commerce.¹² Even the interest of \$123.30 was paid by Valley Farm on October 30 and deposited in Walton's account.¹³ These two payments were recorded in the "directors' loans payable" ledger of the company. Then, on October 31, the balance of \$75,000 was paid to Owen, first by transfer of that amount from Valley Farm to Morgan, and on November 26 by Morgan's certified cheque; another debit was recorded on the directors' loans payable ledger in the books of Valley Farm, described as "to C. P. Morgan from Bank re Arcan transfer N.R.P.C. Morgan re Arcan Owen".

Owen's holdings of Arcan stock, after selling 100,000 shares to Morgan, remained in the neighbourhood of 150,000 shares until June 1965, when it was increased by some 20,000 or 30,000, although Armstrong was in October 1962 compelled to surrender the 285,000 shares issued to him and his associates on September 18, a transaction which Arcan's solicitors considered to be invalid. In settlement he received 61,800 shares of which 10,600 were distributed amongst certain employees of the company to whom he had made commitments. Thereafter his holdings remained constant at 51,200 until May 1965, when he, like Owen, made additional purchases. For the duration of Morgan's control of Arcan it is estimated that Owen and Armstrong between them held 220,000 shares, at least, out of a total of 894,909 issued and outstanding at March 31, 1965,¹⁴ and Owen never appeared to be far from the Arcan scene during those years when he was excluded from its board of directors. But in the meantime Gerald Groship became president of the company and J. C. Laidlaw a director as Morgan's particular representative. Walter Pahn, another employee of Chartered Management Consultants, became, on November 26, 1962, president of Selectra Industries,¹⁵ Pneuma-Serve,¹⁶ and another minor and hopelessly unprofitable subsidiary called King Fixit Marts Limited.¹⁷

Employment of Atlantic Funds by the New Regime

An outcome of the annual meeting of shareholders, held on September 2, 1962 with flagrant disregard for their convenience at South River, was the appointment of two firms of auditors, A. F. McLaren & Co., formerly McLaren & Armstrong, with which R. A. Armstrong had been connected, and Touche, Ross, Bailey & Smart, to be jointly

¹²Exhibit 1262.

¹³Exhibit 2999.

¹⁴Exhibit 2539.

¹⁵Exhibit 2956.

¹⁶Exhibit 2528.

¹⁷Exhibit 2527.

auditors of the company. As a result of the subsequent change of management the McLaren firm resigned from this position and, at Groship's suggestion, Gilbert R. Barrett & Co. were appointed on June 4, 1963 to take their place. Barrett acted as a financial consultant to the Morgan-Groship team and had acted as trustee in connection with proposals of Selectra Industries, Pneuma-Serve and King Fixit Marts, made by these companies to their creditors and filed in July 1962. The proposals were approved by the Supreme Court in Bankruptcy on September 12, and it was part of the original agreement between the Morgan and Owen groups that the former would provide funds to these subsidiary companies for their implementation. This was done, at least in the case of Selectra and Pneuma-Serve, although not in the case of King Fixit Marts which was allowed to default, with loans from Aurora Leasing Corporation. Before examining these loans it should be said that Barrett had on January 4, 1962 bought 1,000 shares of Selectra Industries for \$2,500 through his brokerage account at the offices of Merrill, Lynch, Pierce, Fenner & Smith¹ and remained a shareholder according to the records of the Guaranty Trust Company of Canada, the registrar and transfer agent, until September 8, 1966. His position as principal of a firm acting as auditors of Arcan Corporation from June 4, 1963 was therefore inconsistent with that of a shareholder of one of its subsidiary companies, the financial statements of which were consolidated with those of its parent. The chronology of these appointments of auditors would indicate that the decline in the reported value of the shareholders' equity from \$1,617,087.73 at March 31, 1962² to \$332,487 at March 31, 1963³ was attributed solely to the scrutiny of Touche, Ross, Bailey & Smart. The next annual statement for the year ended March 31, 1964, a soberly designed document in marked contrast to its brightly-coloured and freely-illustrated predecessor, with pictures of the Bon Ami "Mrs. Canada" pageant on which Groship had lavished considerable time and money, revealed a disastrous situation, with the shareholders' equity wiped out and in a deficit position of \$131,384.⁴

From the time that C. P. Morgan took over control of Arcan Corporation on November 26, 1962, with high hopes of restoring the listing of its shares on the Toronto Stock Exchange, its history is one of persistent losses caused by wasteful and incompetent management and accompanied by the familiar flow of Atlantic Acceptance funds in the form of loans which must now be referred to. Between January 8, and June 28, 1963 Aurora Leasing Corporation lent \$271,000 to Arcan

¹Exhibit 3007.

²Exhibit 148.

³Exhibit 149.

⁴Exhibit 150.

OTHER MAJOR LOANS

during a period when the company's income amounted to only \$18,134.60. These funds were disbursed as follows:⁵

Source of funds:

Aurora Leasing Corporation Limited..	\$271,000.00
Sundry receipts	18,134.60

\$289,134.60

Disposition of funds:

<i>Paid to</i>	<i>Amount</i>	<i>Particulars</i>
Gilbert R. Barrett & Co.	\$32,000.00	Advances to trustee for Pneuma-Serve Limited, Selectra Industries Limited and King Fixit Marts Limited, subsequently written off.
Pneuma-Serve Limited..	8,291.34	Accounts receivable, subsequently written off.
Various creditors of Pneuma-Serve	3,281.51	
Charcoal Supply & Sales of Ontario Limited ..	47,900.00	Inter-company account.
Westworld Artists Productions, Inc.	50,067.67	Accounts receivable — Westworld, subsequently written off.
Valley Farm & Enterprises Limited	47,300.00	
Fisher Glickman	1,000.00	
Phillips, Nizer & Benjamin	5,000.00	
Exchange on above \$5,000.00 U.S.	403.12	Expense—exchange.
Bon Ami, Limited	54,500.00	Inter-company account.
Bon Ami, Limited	2,550.00	Expense—debenture interest.
Trans Canada Millinery Sales Limited	5,000.00	Expense—travelling.
Trans Canada Millinery Sales Limited	5,740.00	Expense—management fees.
Aurora Leasing Corporation Limited	1,503.84	Expense—interest on notes.
Selectra Industries Limited	1,800.00	Accounts receivable, subsequently written off.
Various creditors of Selectra	5,102.63	
Various other payments, primarily legal, audit and trust company fees, operating expenses and small advances to and on behalf of other associated companies	17,694.49	
	<u>\$289,134.60</u>	

⁵Exhibit 2544.

It will be seen that a large proportion was used in propping up subsidiary companies all of which was written off except the advances made to Bon Ami Limited, the only useful member of the group. The fact, however, that the cheque for overdue interest on the debenture held by Standard International Corporation was issued by Bon Ami, and not by Arcan, caused alarm at Standard's head office in Andover, Massachusetts and provoked inquiries which were to embarrass Morgan and Groship early in 1965. Since the interest was properly payable by Arcan, there was no justification for showing it as an advance to Bon Ami in the amount of \$2,550, and the consequences far outweighed any apparent advantage to the parent company's accounts. The two payments made to Trans Canada Millinery Sales Limited, an unrelated Groship enterprise, for travelling expenses and management fees also required an explanation which Groship was only able to give in connection with the former, a portion of which, as he said, being incurred on behalf of Arcan Corporation.⁶ Of the \$103,770.79 paid out to or on behalf of Westworld Artists Productions, Arcan paid \$43,300 to Valley Farm and Enterprises;⁷ of this \$34,621 was used to flatten a notes receivable account with Benjamin Oremland in trust to whom money had been advanced for Westworld by Valley Farm during the previous six months, together with \$1,879 to pay interest incurred on the loans; the balance of \$10,800 was credited to "directors' loans payable" and used to reimburse C. P. Morgan for his loan of \$10,000 in U.S. funds to Westworld.⁸ The indebtedness of Arcan to Aurora Leasing during this period was incurred by a loan of \$15,000 direct to Charcoal Supply & Sales to meet operating expenses on January 9, 1963, and the assumption of a \$10,000 debt to Valley Farm and Enterprises by Aurora Leasing on February 13, 1963.⁹

The repayment of this debt was considered by a meeting of the directors of Arcan Corporation on July 16, 1963,¹⁰ attended by Groship, Laidlaw and L. Libman, according to the record, at which Groship reported that arrangements had been made with Associated Canadian Holdings Limited to borrow \$339,500, to be secured by a 7% convertible debenture due July 15, 1967 with a face value of \$350,000, providing that the holder could convert it, in whole or in part, into common shares of the company in a maximum amount of \$636,364. Associated Canadian Holdings, which was of course the holding company owned by C. P. Morgan, Jack Tramiel and Manfred Kapp and members of their respective families, borrowed Atlantic funds through Aurora Leasing Corporation at 8½% per annum for the purpose of making the loan.

⁶Evidence Volume 50.

⁷Exhibit 1259.

⁸Chapter XIII, p. 838.

⁹Exhibit 2532.

¹⁰Exhibit 144.

OTHER MAJOR LOANS

The borrowed money was disbursed as follows¹¹ between July 17 and August 1, 1963:

<u>Paid to</u>	<u>Particulars</u>	<u>Amount</u>
Aurora Leasing Corporation Limited...	Notes Payable . . . \$281,000.00	
	Interest expense . . . 3,051.37	
Aurora Leasing Corporation Limited...	Note payable 15,000.00	
	Interest expense . . . 173.84	
		<hr/>
N.G.K. Investments Limited.....	Shareholders' expense, subsequently transferred to debenture discount	\$299,225.21
		<hr/>
Charcoal Supply & Sales of Ontario Limited.....	Bond & Cosman Limited accounts receivable re Charcoal's cheque #9534 of same date to Bond & Cosman Limited	10,500.00
		<hr/>
Bond & Cosman Limited.....	Accounts receivable	5,000.00
Bond & Cosman Limited.....	Accounts receivable	3,000.00
Bond & Cosman Limited.....	Accounts receivable	2,000.00
Bond & Cosman Limited.....	Accounts receivable	4,600.00
		<hr/>
		19,600.00
Trans Canada Millinery Sales Limited..	Accounts receivable, subsequently written off	
		<hr/>
		7,800.00
Wood Fleming & Co. Limited.....	Accounts receivable Bon Ami, Limited re rent	
		<hr/>
		5,500.00
Various payments to and on behalf of Westworld Artists Productions, Inc..	Accounts receivable, subsequently written off	
		<hr/>
		2,423.46
Sundry trade payments, legal and audit fees.....		
		<hr/>
		4,951.33
		<hr/>
		\$350,000.00

Here it will be noted that the full amount of \$350,000, as secured by the debenture to Associated Canadian Holdings, was advanced and disbursed, the difference from the amount referred to by Groship of \$339,500 representing the amount paid to N.G.K. Investments Limited of \$10,500, particularized as "shareholders' expense, subsequently transferred to debenture discount". In the books of N.G.K. Investments¹² this payment was taken into income as a finder's fee, to be added to the many such payments by which this company, controlled by Morgan and his associates, was to be enriched. For the rest, it will be observed that almost \$300,000 went back to Aurora to repay its loan to the Arcan group of companies with interest; five payments, amounting in all to \$19,600, were made between July 17 and August 29 to another unrelated Groship company, Bond & Cosman Limited; a further \$7,800 was paid on July 29 to his Trans Canada Millinery Sales; and for these payments to his two companies, one of which was written off, Groship had no real

¹¹Exhibit 2545.

¹²Exhibit 1241.

explanation of any kind. It may be said here that although his evidence before the Commission was given with considerable fluency, it was punctuated throughout with disclaimers of any knowledge of most of the transactions which required explanation, and he evidently wished the Commission to consider him as a man devoted solely to sales promotion, with the responsibility for providing funds resting on the shoulders of C. P. Morgan or executive aides like Woolfrey of Commodore Sales Acceptance and Graham Bartlett, the Arcan book-keeper.

Under the circumstances already described it is not surprising that these infusions of Atlantic funds were insufficient for the needs of Arcan Corporation, now firmly in the hands of a combination of sales and stock promoters to whom manufacturing was a mystery. Between November 25, 1963 and March 4, 1964 Aurora Leasing lent a further \$94,000 to Charcoal Supply & Sales at the usual rate of 9%; the borrower succeeded in making a payment of \$15,000 on August 18, 1964 and on December 23 Aurora advanced another \$7,185. Between December 11, 1963 and June 1, 1965 Charcoal Supply & Sales did, however, pay \$10,406.38 in interest to Aurora, and only \$1,933 was owing for interest at the date of the latter company's bankruptcy on July 31, 1965. Arcan paid interest of \$24,500 on the debenture held by Associated Canadian Holdings on October 7, 1964 at the 7% rate and had to borrow this amount from Aurora Leasing at 9% in order to do so. Between April 1 and April 22, 1965 three additional advances were made in small amounts, bringing the total outstanding to \$29,700, eventually paid by Arcan on October 10, 1965 into court to relieve against a petition in bankruptcy filed against it on July 29.¹³

Standard International Corporation Intervenes

It would be idle to pursue in detail the various indications of approaching insolvency in the affairs of Arcan Corporation during the two and a half years of Morgan's control of its affairs, except to note that the moneys advanced to subsidiaries other than Bon Ami were, almost without exception, irrecoverably lost. Bon Ami and Charcoal Supply & Sales paid during the period \$65,498.92 in management fees to Eila Investments Limited and \$155,441.63 in brokerage fees to Ansy McLean Limited under the expensive and unproductive arrangements entered into with D. P. Owen. The charcoal company consistently lost money and Bon Ami barely kept its head above water; as for Selectra, Pneuma-Serve and Westworld their operations were hardly worthy of the name. For the fiscal year ended March 31, 1965 Arcan reported total income of only \$333.03¹ and at this point the anxieties of Standard International Corporation were perceptibly sharpened. The American company considered

¹³Exhibit 2542.

¹Exhibit 2539.

the \$100,000 debenture, taken by its predecessor as part payment for Arcan's acquisition of control of Bon Ami Limited, to be in default because of interest considered to be in arrears, and they felt with some reason that their own 40% interest was in jeopardy because of the use of Bon Ami's income to pay expenses of other constituents of the Arcan group. As early as January 1964 Standard's vice-president C. J. McCarthy, who testified to the Commission on September 13, 1966,² urged Morgan to place a value on the Canadian Bon Ami company and give Standard International the opportunity either to buy Arcan's 60% or sell the 40% which it had retained. Nothing came of this suggestion at the time, but a year later, on January 13, 1965, the representatives of Standard International on the board of Bon Ami Limited, at one of its infrequent meetings, made a determined attack on Groship's management. J. C. Laidlaw, vice-president of Arcan and a director of Bon Ami, gave Morgan a very full and ominous report on January 15.³

"Dear Powell:

Although you have probably received some details regarding Wednesday's meeting of Bon Ami directors, I will attempt to fill you in on particulars without being too repetitious or lengthy.

Attending the meeting as you know, were Messrs. Hogan and McCarthy from Lestoil and Groship, Rubin and myself representing the Canadian Company. In addition, Mr. Mayer, our legal council, was present along with Mr. Crawford from Holyoke and Mr. Rogers, their lawyer.

It was obvious from the start that the Americans were there to dig deep and probe as much information regarding the financial statement and operation of the company as possible. Most of their questions and motions were to the point and no doubt caused Mr. Groship some embarrassment, which is understandable under the circumstances. Naturally Groship, Rubin and I voted unanimously on all issues and with the exception of one motion the count was 3-2.

It is most difficult to contribute much to such meetings as up until noon on Wednesday I was completely in the dark about the statement itself, summary of operations during the year and other activities of Mr. Groship relating to Bon Ami. A year ago it was agreed at the annual meeting that the statement for the year ending March, 1964 would be available for review by the directors, four months after the close of the business year. There were no interim statements or meetings to brief either myself or Mr. Rubin and, as you know, the annual statement although dated September 22 was not ready until Wednesday."

There follows a lengthy itemized list indicating that Hogan and McCarthy of Lestoil (Laidlaw using this name to describe Standard International Corporation which manufactured this product) were well aware of

²Evidence Volume 57.

³Exhibit 1081.

Groship's shortcomings and particularly his preoccupation with enterprises of his own. Included in the list of items discussed was the following reference to auditors:

- "5. Insistence of Messrs. Hogan and McCarthy that Touche, Ross Bailey and Smart be retained as auditors even though this means two auditing firms for Bon Ami and duplicated expense. Prior to the meeting Groship advised me that it was your wish to retain Gilbert Barrett & Co. and drop Touche, Ross, Bailey and Smart. Is that so?"

This letter concludes with a paragraph which Morgan, had he had any confidence in Laidlaw's judgment, should have taken to heart:

"Two years ago when I first went on the board at Arcan, Charcoal Supply and Bon Ami I was hopeful that I would have the opportunity of learning all about the operation. This would have meant being given the proper authority to spend some time on the premises, check the records and expenses and study the method of merchandising and selling. Unfortunately this did not happen so I have been more or less in the dark. Even with my limited knowledge however I feel that there has been gross mismanagement on Mr. Groship's part, and this has been substantiated by others who have been directly or indirectly connected with the firm.

I trust that my remarks will not be considered impertinent and that this report is of some value to you."

According to McCarthy, Morgan told him that he wished to get rid of Groship and from this point on he appears to have given favourable consideration to a solution of the divided ownership of Bon Ami. On March 23 Morgan invited McCarthy to attend a meeting of six Arcan shareholders, at which Groship was not present, apparently with a view to reorganizing management of the company, but the plan, seriously contemplated, evidently miscarried because at the annual meeting on March 30, which took place some six months later than customary with a consequent postponement of consideration of the financial statements for the year ended March 30, 1964, all but one of the retiring directors were re-elected and Touche, Ross, Bailey & Smart were not re-appointed. None the less, during the first meeting Morgan is reported to have telephoned the Bon Ami office and left instructions to make no more payments on the Eila and Ansy McLean contracts. The climax came on March 29 when McCarthy attended another meeting at the Bon Ami office at which Bartlett typed out resignations as officers and directors of that company for signature by himself and Groship, and later in the day there was a meeting of Morgan, Wagman and Tramiel, Solomon as solicitor for Associated Canadian Holdings, Bernard Mayer as solicitor for Arcan, A. J. Horning and Gerald Groship. McCarthy was accompanied by Messrs. Hogan and Crawford of Standard International

OTHER MAJOR LOANS

Corporation and, after Morgan had summarized the discussion, McCarthy left with the impression that an agreement had been reached, permitting Standard International to buy Arcan's interest in Bon Ami Limited and Arcan to redeem its \$100,000 debenture as part of the consideration. When D. P. Owen was advised of these developments he fought hard against them throughout the month of April; and finally, on May 4, the rival groups met at the offices of J. P. Manley Q.C., Owen's legal adviser. Owen's account of what led up to the meeting and what transpired there and thereafter, as given in his evidence to the Commission, is well worth reproducing.⁴

"Q. As a result of your concern, what steps did you take, sir?

A. Well, I was told by Mr. Groship some time, I think in March of 1965, that Mr. Morgan had directed him or had told him that the interest that Arcan held in Bon Ami was going to be sold, and at the same time there was going to be a change in the management of the Arcan Corporation, at an annual meeting which was to be held very soon. And he would hand over the control of that company to another group, which would have Arcan without Bon Ami. I, of course, was immediately interested in this, wearing three hats, a shareholder of Arcan, the consultancy agreement, the merchandising agreements, and so it was with some difficulty I met with Mr. Morgan.

Mr. Morgan told me that he was under great pressure from Standard International of Boston, to the point where I think he used the words, he felt he was being blackmailed, that he had all kinds of actions threatened against him unless he disposed of the 60 per cent or arranged for Arcan to sell it. I told him that I was opposed to it, that I would take all steps, legal and otherwise, within my command, to see that Arcan did not dispose of its main interest. What I considered then and now to be its prime interest. Mr. Morgan then asked me to meet with Standard International, and so a meeting was arranged at the offices of the solicitor, the then solicitor for Arcan, at which Standard International were represented by a Mr. McCarthy and Mr. Crawford. I cannot recollect whether the president, Mr. Hogg, was there at the first meeting. A Mr. Barrett, Mr. Morgan, Mr. Groship and Mr. Mayer. I think there were one or two other bodies around, but I can't remember who they were. I was told at that meeting what the proposal was, that they were going to purchase the 60 per cent for \$50,000 cash, to be paid at the rate of \$5,000 a year without interest, over a period of ten years, and that they were going to cancel the debenture of \$100,000 that was owed on the initial purchase by Arcan to the successor of the Bon Ami Company, Standard International.

And I think there was going to be an assignment of a note held on a company which had formerly been a subsidiary of Arcan, but had been sold, somewhere around \$60,000. At that meeting Mr. Crawford assured me that my contracts were not in danger and that they would

⁴Evidence Volume 58, pp. 7827-32.

be upheld, and he even used the phrase that they hoped they would get some benefit out of them.

And I told that meeting I was not there to discuss my contracts, that I was there to discuss the position of Arcan, on behalf of myself and other shareholders, because I have interested many people in Arcan over the years, and that I would not discuss my personal position until the situation regarding the assets of Arcan was settled. And I used the phrase, when I found we were getting nowhere, that I intended to block the sale. Whereupon Mr. Crawford said, 'In that case we will see that your contracts are put to an end.'

They also made it very clear, on behalf of the Standard International, that they were prepared to go to any length, to use any weapon, to see that that 60 per cent was returned to them either on a purchase or by some adjustment of accounts.

The meeting left and Mr. Morgan had a couple of meetings with me. He wanted—he said: 'Don't worry, I will put in something into Arcan that will more than take the place of Bon Ami.'

And millions were wafted around the room. I said I wasn't interested. I liked the Bon Ami situation the way it was. And so Mr. Morgan agreed to meet at the office of Mr. Manley, who had been introduced into the situation, where he was going to tell Standard International that the arrangement he had made or undertaken to see—the influence—he started to change his grounds slightly. In other words, he said he hadn't actually entered into a contract to use his influence to see certain things happened, I understand. I wasn't there. This arrangement was made in a room in which Mr. Hogan, Donald E. Hogan, I think is the name of Standard International, and Mr. Morgan were present.

They left the larger meeting and went into a private office to make this arrangement. This pre-dated any knowledge I had of an arrangement.

Well, we arrived at the offices of Mr. Manley, and I, and I think Mr. Armstrong was there, I am not sure, because I always consult Mr. Armstrong on anything where dollars are concerned. We were in one room and the Standard International faction, together with Mr. Mayer, who was still solicitor for Arcan, came in and occupied the Manley boardroom, and we waited about two hours in our room and we never got together. But they were told all arrangements were off, and we all went home to bed about eleven o'clock or ten-thirty, somewhere in there.

I learned the next morning that Mr. Morgan had risen from his bed, I don't know, I presume somewhere between eleven and twelve or twelve-thirty, and contacted one of the many solicitors he used, and had gone down to the Westbury Hotel, where he met with the Standard International people, and I had come to understand, had entered into some other kind of an arrangement, where the 60 per cent was going to disappear once more.

Q. What date was this, sir?

A. This would be some time, I think, in April. It must have been in

April. Morgan then phoned me up and said he really wanted to get out of this because a threat, such as by Standard International against himself, and the threat of the involvement of Atlantic Acceptance, was something he could not tolerate, and he would go to all kinds of lengths to avoid an issue being made. And he called me down to his office because he said that he had been given until twelve o'clock that day to either sell—through the arrangement, to sell the 60 per cent or purchase the 40 per cent of Bon Ami Limited from Standard International for \$525,000.

I told him he was mad. But the twelve o'clock hour came. By this time there were various solicitors and accountants for Atlantic there, and Morgan, in the end, made a written offer, which was to be accepted by three o'clock, of \$425,000, I think the figure was, for the 40 per cent interest that Standard International held in the Bon Ami Company Limited, and they turned it down."

D. P. Owen Resumes Control

Some allowance must be made for Owen's lack of precise recollection of names and dates, but this account has a dramatic quality of its own, showing that Morgan at this point in March 1965, harried by a multitude of problems and anxieties, had become irresolute and confused. He now turned to Owen, asking him to handle a situation which had been complicated by the issue of a writ by Standard International Corporation in the Supreme Court against Arcan Corporation, Bon Ami Limited, Charcoal Supply & Sales, Ansy McLean, Eila Investments, Morgan, Owen, Armstrong and the Arcan directors,¹ alleging conversion of Bon Ami assets and asking for injunctions and damages. Although no action had been taken under the old \$100,000 debenture, Owen saw its existence as the main threat to Arcan's position and it was redeemed on May 18 by Associated Canadian Holdings paying Standard International Corporation \$112,070.53. This payment was made up of a loan of \$75,000 from Holte Motors Limited, another Owen company, and \$24,000 from C. P. Morgan, the balance being contributed by Associated Canadian Holdings itself, with an undertaking to Owen that as long as his \$75,000 loan remained outstanding Associated Canadian Holdings would not, in the event of default upon its \$350,000 debenture, put Arcan into receivership. It was contemplated that this debenture would be enlarged to secure \$500,000 and its convertibility reduced to a price of 20¢ per share, but this had not been done by the time the Arcan directors next met on June 24, 1965, and the additional \$37,927 to be advanced by Associated Canadian Holdings to Arcan was evidently not produced. At this meeting, held after the default of Atlantic Acceptance, the board of Arcan Corporation, reduced by the resignation of four of its seven members between April 27 and May 6, consisted only of Groship, Bartlett and Laidlaw. Groship and Bartlett combined against

¹Exhibit 2549.

Laidlaw to appoint Owen, Armstrong and their associate H. J. Cooper to fill three of the vacancies, and on July 6 the resignations of Bartlett and Laidlaw were accepted. Thus, and without effort, the Morgan regime was brought to an end, and in due course his remaining 5,500 shares were sold out by his bank in May 1966 at a price of 1¢ per share and much to his disgust.² The following schedule,³ introduced into evidence by Mr. D. J. Burnett, C.A.⁴ who, with Mr. R. A. Francis, C.A.⁵ of Harbinson, Glover & Co., chartered accountants, testified to the Commission about the transactions of Arcan Corporation, sets out its indebtedness and, where indicated, that of its subsidiary company Charcoal Supply & Sales of Ontario to Associated Canadian Holdings, Aurora Leasing Corporation, D. P. Owen and C. P. Morgan as at July 31, 1965:

Associated Canadian Holdings Limited:	
7% debenture due July 15, 1967	\$350,000
Aurora Leasing Corporation Limited:	
Notes payable, 9%—Arcan	29,700 (1)
—Charcoal	86,185
D. P. Owen:	
Loan payable	75,000 (2)
C. P. Morgan:	
Loan payable	37,073 (2)
	<hr/>
	577,958
Add: The following liabilities unrecorded in the books of Arcan and Charcoal:	
Interest due July 15, 1965 on \$350,000 debenture	24,500
Overdue interest on interest of \$24,500 due July 15, 1964 and not paid until October 7, 1964 @ 7%	429
Interest receivable per books of Aurora at July 31, 1965:	
—Arcan	1,935
—Charcoal	1,933
	<hr/>
	\$606,755

Notes: 1. On October 10, 1965 the books of Arcan reflect the payment of the \$29,700 by way of a cheque to the Supreme Court of Ontario.

2. No interest rate or security is recorded.

It may be noted that the books of Arcan, by journal entry, credited Owen with \$75,000 and Morgan with \$37,073 in connection with the redemption of the debenture given to Standard International Corporation for the balance payable on purchase of the company's interest in Bon Ami

²Exhibit 3878.

⁸Exhibit 2542.

⁴Evidence Volume 49.

⁸Evidence Volume 57.

OTHER MAJOR LOANS

Limited,⁶ and that Associated Canadian Holdings apparently only acted as a disbursing agent, debiting the whole amount of the payment of \$112,070.53 to a suspense account.⁷ Of the total indebtedness shown above the principal amounts owing to Aurora Leasing Corporation and Associated Canadian Holdings, all of which were advanced by Aurora Leasing and obtained by it from Commodore Sales Acceptance, were \$478,958 in the aggregate, on which at July 31, 1965 there was interest accrued and unpaid of \$28,797. It has been seen that \$29,700 was subsequently paid into court to the credit of Aurora Leasing, reducing the unpaid principal to \$449,258.

Estimate of Loss by The Clarkson Company Limited

Both the action brought by Standard International and one launched by the Clarkson Company Limited, as trustee of the estate of Associated Canadian Holdings, against Arcan, Owen, Armstrong and Bon Ami Limited, in respect of the Arcan debenture of \$350,000 given to Associated have now been settled and it is possible to estimate the loss of Atlantic funds in the light of these arrangements, and of supplementary settlements of claims by the Clarkson Company, as trustee for both Associated Canadian Holdings and Aurora Leasing, against Arcan and Charcoal Supply and by the receiver and manager of Commodore Sales Acceptance against the former. On September 25, 1968 the Clarkson Company advised the Commission of the loan position at June 20, 1968 and the recovery expected from the general settlement in the following terms:

"With regard to the final loss on this account, we set out the following schedule:

Loans outstanding at date of settlement

Aurora Leasing Corporation Limited

Arcan Corporation Limited	\$ 31,635	
Charcoal Supply & Sales of Ontario Limited	88,119	\$119,754

Associated Canadian Holdings Limited

Demand loan	37,000	
Debenture	350,000	387,000
		<u>506,754</u>

Estimated recovery under settlement with

Standard International Corporation	356,000
--	---------

Anticipated loss of 'Arcan accounts'	<u>\$150,754</u>
--	------------------

As discussed with you by telephone, the above debts do not include any interest other than that booked by the debtor companies prior to the Atlantic collapse. The approximate interest that would have been earned would be \$150,000."

⁶Exhibit 2532.

⁷Exhibit 2165.

Standard International Corporation received the interest of Arcan Corporation in Bon Ami Limited and the trustee for Associated Canadian Holdings and Aurora Leasing Corporation \$200,000 of Standard International's 5% convertible subordinated debentures due in 1987, with Standard International guaranteeing payment of the principal amount when due. Arcan Corporation recovered the \$29,700 paid into court in respect of the bankruptcy petition of Aurora Leasing, but otherwise found itself more firmly than ever in the hands of D. P. Owen who received an assignment of the claim of Associated Canadian Holdings to the extent of \$37,000 and of the notes of Charcoal Supply & Sales given to Aurora Leasing for the latter's loan of \$86,000, 200,000 of Arcan's common shares and \$75,000 in cash paid by Standard International. Under the terms of this settlement the trustee will not have recovered the expected amount until maturity of the Standard International debenture.

3

Interim Activities of Gerald Groship

The period between September 1959 and November 1962, during which Gerald Groship was excluded from the business of Arcan Corporation, must now be examined in order to account for an extraordinary series of loans which caused losses of upwards of \$3,000,000 to Commodore Sales Acceptance and which were advanced to companies of Groship's contriving. He was born in Toronto in 1910 and his education appears to have consisted largely of some technical training in the printing business and courses in advertising and sales, taken at night school and under the university extension schemes. Before the last war he had some experience in sales promotion as a free lance operator and afterwards evidently found his feet with the Oshawa Wholesale organization. By the autumn of 1959 his wife Sylvia had been operating a millinery store under the name of William's Hat Shop for over two years and he himself had become interested in the activities of low-priced millinery retailers in communities outside Toronto. In November he opened a shop at 290 Eglinton Avenue West known as the "Hat Mart", the declaration of proprietorship in this venture being drawn and registered by Carl M. Solomon whose office at the time was at 62 Richmond Street West, adjacent to that of Walton, Wagman & Co., the auditors of Mrs. Groship's business. W. L. Walton and Gerald Groship had known each other since childhood and this knowledge was to prove expensive to Atlantic Acceptance Corporation.

On Groship's first appearance before the Commission¹ he said that the Hat Mart was sufficiently successful to encourage him to open another shop on Yonge Street in the downtown area of Toronto in 1960.

¹Evidence Volume 40.

Yet the financial statement for the period November 26 to December 31, 1959, prepared by Perlmutter, Orenstein, Giddens, Newman & Co., shows that the Hat Mart lost over \$3,000 in its first month, and in the course of the next year the two stores, without the injection of "miscellaneous income", would have shown a substantial loss on sales.² On March 17, 1960 the business was incorporated under the name of Trans Canada Millinery Sales Limited as a private company with Gerald Groship as president, his brother David, vice-president and a Mrs. Lyal Noel-Bentley as secretary.³ In June 1961 a new venture was opened on Eglinton Avenue West known as the "Pet Mart" and on August 1 Trans Canada Millinery Sales assumed the assets and liabilities of Chatsworth Enterprises Limited, the three outstanding shares of which had been bought by Groship on May 22. Chatsworth Enterprises, which had operated two hat shops in Montreal, thereupon ceased to be active until the spring of 1964, when it was revived to take its place in a larger and more extravagant venture.

As already observed, Groship said in evidence that after his experience with Oshawa Wholesale and Arcan Corporation he had intended to undertake business on a more modest scale, but an exciting prospect was opening before him. On December 10, 1959 an American concern, called Towers Marts International Inc., caused to be incorporated Towers Marts of Canada Limited the undertaking and operations of which were taken over by another company by the name of Towers Marts & Properties Limited, incorporated on July 21, 1961. The idea behind this activity was the promotion of a chain of discount stores in which the various departments would be operated by separate individuals or companies acting as concessionaires. It has been seen in Chapter VII, dealing with the commitment of Atlantic funds to the retail operations of Frederick's Department Store and the Treasure Island Shopping Centre in London, Ontario, that 1961 was the year in which C. P. Morgan's enthusiasm for discount merchandising was at its height. Trans Canada Millinery received a concession during the early stage of this development in the Towers discount department store in Scarborough Township. Encouraged by results of sales in March and April, Groship turned to W. L. Walton and Harry Wagman for the financing of millinery and pet concessions in seven Towers stores due to be completed by the end of 1961, and forecast annual sales of upwards of \$750,000.⁴ On July 10 an agreement was concluded to have Hilltop Holdings Limited advance money to Trans Canada Millinery and by July 17 \$23,420 had been loaned.⁵ A floating charge debenture was given to Hilltop Holdings on July 14 by Gerald Groship, carrying on business as the Hat Mart and

²Exhibit 1830.

³Exhibit 440.

⁴Exhibit 1794.

⁵Exhibit 1794.

the Pet Mart, in contemplation of loans not to exceed \$150,000 and provision was made for the transfer of Groship's assets to Trans Canada Millinery Sales, an event which occurred on August 1. The rate of interest provided by the debenture was 15% per annum which must be regarded as some indication of the risk which the lenders considered was being run, even at this stage of Groship's retail operations.

Walton and Wagman were in no position to sustain even this modest commitment to Groship without the assistance to which they had become accustomed, and by August 18 had offset a loan of \$58,420 at 15% to Groship by borrowing \$35,000 at 12% from Commodore Sales Acceptance. They had promised Groship \$75,000 to enable him to open up some new Towers locations in Toronto and re-open in Montreal two millinery shops taken over from Chatsworth Enterprises. The Towers organization, however, had still more elaborate plans in the making of which Groship was prepared to take advantage, and at this point Walton and Wagman arranged a luncheon appointment with Morgan who told him that Hilltop Holdings had reached its limit with the money already advanced and the guarantee of Trans Canada Millinery's \$37,000 overdraft at the Canadian Imperial Bank of Commerce. Morgan was prepared to have Commodore Sales Acceptance assume the burden of advancing the remainder of the \$150,000 originally contemplated; for a time, however, Hilltop Holdings continued to be a conduit through which money was advanced to Groship. On September 19 Walton wrote a personal letter to him, pointing out that, after making an additional deposit of \$75,000 to his credit, his overdraft was still \$643 and that, under the circumstances of the company guaranteeing the overdraft, the total indebtedness to Hilltop amounted to \$134,063.16. On December 22, 1961 Commodore Sales Acceptance took over Hilltop's receivable position in its entirety.

Bond & Cosman Limited and Trans Canada Millinery Sales Limited

During the latter part of 1961, according to advice given to the companies' branch of the Provincial Secretary's Department by E. N. Kemp, an employee of Arcan Corporation, on April 27, 1962, and by Mr. and Mrs. D. P. Owen on January 10, 1964,¹ the shares of a company known as Bond & Cosman Limited had been transferred by the Owens to Gerald Groship, David Groship and Mrs. Noel-Bentley. Bond & Cosman, a private company incorporated in Ontario on February 29, 1956 for the purpose of selling dry goods, was a "shell" which Groship needed to expand his concessions in the Towers stores, and his friend Owen was able to accommodate him on terms which have not been disclosed. Commodore Sales Acceptance then proceeded to make advances to both Trans Canada Millinery Sales and Bond & Cosman which, for

¹Exhibit 375.

OTHER MAJOR LOANS

some six months at least, were secured by promissory notes bearing interest at 12%.² On December 20, 1961 Trans Canada Millinery Sales delivered a debenture to Commodore Sales Acceptance providing a first charge upon all its property, undertaking and assets, present and future, located in its four Toronto and Montreal millinery stores, its Toronto pet store and its concession in the first nine Towers stores at Scarborough, Cooksville, Burlington, St. Catharines, Waterloo and London in Ontario, in two stores in Montreal and one in Ste. Foy in Quebec, as security for indebtedness not to exceed \$275,000. The debenture, which was guaranteed by Gerald Groship, was to become due and payable on December 31 1962.³ A similar obligation⁴ was taken by Commodore Sales Acceptance from Bond & Cosman to secure up to \$500,000 on February 23, 1962, due on February 28, 1963. The debentures were renewable at the option of the holder and bore interest at 12% per annum. A. G. Woolfrey described this financing as an "inventory purchase operation"⁵ and Groship described the expansion of Towers stores as "the most rapid retail growth in Canada that I know of."⁶ The concession arrangement was for a lease of open floor space at \$6 per square foot, plus a percentage of the sales of the concessionaire which provided its own stock and staff. The lessor provided security services, cashiers and parcel-wrapping, together with maintenance of the premises both inside and out. Advertising was combined under the Towers name for a fee and the operation in each store had the normal appearance of an integrated department store. In the course of his evidence Groship admitted that his book-keeping fell behind current requirements but that merchandising and operating records were up-to-date; when he was asked about repayment of loans made by Commodore Sales Acceptance he said:⁷

"I honestly can't answer that. I had perhaps too little to do with that part of the business. I was concentrating on the merchandising and sales, and the Walton, Wagman office were handling the liaison between—between our bookkeeping and Commodore."

Woolfrey complained in his evidence to the Commission⁸ about the absence of weekly or monthly figures and added:

"The firm of Chartered Management Consultants Limited attempted to obtain some financial information, and they ran up against a brick wall in that regard because the records were in such deplorable state, and I have not seen any records to this day on the operations of the company or companies. It was a most unsatisfactory arrangement all round as far as I was concerned."

²Exhibit 2307.

³Exhibit 2294.

⁴Exhibit 2292.

⁵Evidence Volume 102.

⁶Evidence Volume 40.

⁷Evidence Volume 40, p. 5515.

⁸Evidence Volume 102, p. 14050.

Finally, in July 1963, Graham Bartlett, office manager for Arcan Corporation, was asked by Morgan to supervise the book-keeping for the Groship companies. In Bartlett's evidence, given to the Commission on May 30, 1966, he described the procedure thus:⁹

"Q. Now what were your duties with the Groship Companies?

A. I was looking after the accounts payable mainly in the beginning. They had a book-keeper and I arranged with Commodore Sales Acceptance the transfer of moneys to and from.

Q. How did these transfers of money from Commodore Sales to the Groship Companies, how did it work—how was it done?

A. It—in the beginning I believe the sales from the Towers Stores were endorsed to Commodore, and money was received from Commodore on notes.

Q. When the Bond and Cosman Companies were carrying on business in the Towers Stores, was the procedure such that Towers would collect all of the money from the retail sales and the concessions in their stores?

A. Yes sir.

Q. Deducting therefrom the cost of the Bond and Cosman Companies by carrying on business or leasing concessions in the stores and remitting a note to the Bond and Cosman Companies?

A. That's correct.

Q. And would you in turn then remit that money over to Commodore Sales Acceptance?

A. Yes.

Q. How was it remitted?

A. The cheques were endorsed and given to Commodore.

Q. And who at Commodore would receive those cheques?

A. Miss McGivney or Mr. Woolfrey.

Q. Was this arrangement made that the Bond and Cosman Companies would not have any revenue of their own then?

A. Yes, yes.

Q. All of their revenue went directly to Commodore Sales?

A. In some cases it went directly to Bond and Cosman's bank as well.

Q. In which cases?

A. Well, if there was no one to see, if Mr. Woolfrey was not there and nothing could be done, the situation altered. Sometimes it went directly but usually it went to Commodore.

⁹Evidence Volume 39, pp. 5398-400.

OTHER MAJOR LOANS

Q. I see. When that occurred, what about revenue, what about the operating expenses of the Bond and Cosman companies, where would those funds come from?

A. It came from Commodore.

Q. And what method was employed to receive those funds?

A. They were received on notes, signed notes.

Q. And who would sign those notes?

A. Mr. Groship."

As usual, Woolfrey's hands were tied by the fact that Groship dealt with Morgan directly rather than with him and said, "I knew so very little about the Towers operations the matter was not discussed with me to any great extent except when Mr. Morgan requested funds to be advanced to the Groship complex".

Operations in the Towers Stores

Before examining the extent and distribution of the loans made by Commodore Sales Acceptance to sustain this rapidly growing retail network it should be noted that Morgan's interest in discount store operations, and in the Towers enterprises in particular, caused Aurora Leasing Corporation to lease equipment to Towers Marts & Properties for the only two stores which it actually owned in London and Waterloo, Ontario. Rental payments for five years under the lease negotiated in February 1962 would amount to \$776,972.82. However a year later, on March 4, 1963, W. L. Walton was appointed interim receiver of Towers Marts & Properties and on July 8, under the trusteeship of the Clarkson Company Limited, it made a proposal to its creditors which was accepted and in due course approved by the court. Its liability under the lease of equipment from Aurora was assumed by Allied Towers Merchants Limited, a public company incorporated in Ontario on March 21, 1962, and largely representative of the original Towers interests, which had acquired the shares of most of the companies operating concessions in the Towers stores. Aurora Leasing in August 1963 was compelled to accept reduced rental payments of \$546,636.17 from Allied Towers Merchants over a period of six years rather than five, and became an unsecured creditor of Towers Marts & Properties for the amount of the reduction of \$66,982.17 from that stipulated in the original lease. Allied Towers Merchants had, in effect, taken over the operation of Towers Marts & Properties, as sub-lessees in eleven of the thirteen Towers stores and lessees from Towers Marts & Properties of the two which it owned. In spite of its unsatisfactory experience with this organization Aurora Leasing was the purchaser of \$50,000 worth of the 9% \$1,000,000 subordinated debentures of Allied Towers Merchants on September

15, 1964, and, although at January 31, 1967 \$35,000 of this principal amount remained unpaid, full recovery was expected.¹ The unsecured claim against Towers Mart & Properties was none the less still outstanding at July 30, 1965, the date of Aurora's bankruptcy, in the amount of \$65,982.²

In the early stages of Groship's operations Trans Canada Millinery Sales operated the millinery concessions in the Towers chain and its own stores in Toronto and Montreal, and Bond & Cosman his fabric and pet supply concessions in the Towers chain; but from August 1, 1962 onwards Trans Canada Millinery Sales surrendered its Towers operations to Bond & Cosman and concentrated on the Toronto and Montreal millinery stores. Unaudited financial statements prepared by Walton, Wagman & Co. for Bond & Cosman, operating 39 concessions in the premises of Towers Marts & Properties, showed that for the period from August 1, 1962 to February 28, 1963 the company suffered a loss of \$34,771.68.³ A third company, which became a borrower from Commodore Sales Acceptance, was acquired by Groship from Arcan Corporation on or about February 1, 1962. This was Mart Utilities Limited, incorporated as a private company in Ontario on August 18, 1961 with a capitalization of \$5 and originally contemplated as a holding company for Trans Canada Millinery Sales and Bond & Cosman. The directors and officers of this company were, as before, Gerald Groship, his brother David and Mrs. Noel-Bentley, and, beginning in October of 1962, Groship and one Irving Pomerantz, who joined him at that time, attempted to repeat the House of Arcan experiment in supplying products other than food to supermarkets.⁴ The first advance of \$25,000 at 12% per annum—subsequently increased to 15%—was made by Commodore Sales Acceptance on October 18, 1962,⁵ and Groship and Pomerantz began to buy merchandise on behalf of independent operators and discount retail stores, an activity which was consistent with Groship's tendency to multiply enterprises at the expense of his main effort, observed in his first period of employment by Arcan Corporation. Like Jack Tramiel of Commodore Business Machines he was constantly trying to elude the attempts of C. P. Morgan to control his current activities by beginning new ones with bewildering frequency. At the same time Walton, Wagman & Co. as his accountants were baffled by the confusion in the records of his companies and by his resistance to inventory counts and controls; on July 31, 1962 they were compelled to say that they were unable to express an opinion on the fairness of the balance sheet and statement of operations of Trans Canada Millinery Sales because of the

¹Exhibit 4106.

²Exhibit 587.

³Exhibit 1819.

⁴Evidence Volume 40.

⁵Exhibit 2307

material nature of figures certified by management in respect of inventory.⁶ At this point Trans Canada Millinery was shown to have incurred a deficit in shareholders' equity of \$35,377.13, and Bond & Cosman \$99,716.57.⁷

Advances by Commodore Sales Acceptance

Mr. W. F. Avery, C.A., of Clarkson, Gordon & Co., testified before the Commission on May 30, 1966¹ about the various companies in the Groship group and the manner in which they were financed by Commodore Sales Acceptance. For this purpose he had to rely largely on the records of the latter company because of the insufficiency and confusion of those of all the fifteen companies which Groship brought to life. He also used unaudited statements in the files of Walton, Wagman & Co. and audited financial statements on which, in nearly every case, these accountants expressed no opinion as to the fairness of their representation. From these sources he compiled three schedules the first of which provides a summary of advances from Commodore Sales Acceptance to what he described as the "Bond & Cosman companies", consisting of Bond & Cosman Limited, Trans Canada Millinery Sales Limited and Mart Utilities Limited, and the Little Scot companies about which more must be said. This schedule is appended as Table 53.² It will be seen there that by July 31, 1962 Commodore Sales Acceptance had advanced \$655,000 without receiving any repayment and at July 31, 1963 advances had increased to \$1,369,779, including interest accrued and unpaid which had been capitalized. The repayment of \$389,006 was obtained through the familiar device of a transfer bank account in which deposits were made of cheques payable to the concessionaire companies by Towers Marts & Properties. As at July 31, 1962 Bond & Cosman and Trans Canada Millinery Sales were insolvent and at the following year-end Bond & Cosman, according to the audited statements on which no opinion was expressed, showed a deficit of \$676,871.22 of which an operating loss in the course of the year of \$634,335.97 was the main ingredient. In addition, one of the assets shown was described as an advance to Trans Canada Millinery Sales in the amount of \$237,137.94, largely arising out of the transfer of the operation of the Towers concessions by that company to Bond & Cosman, which the auditors considered to be uncollectible; so that the true deficit position would appear to have been that much larger. Trans Canada Millinery Sales showed at July 31, 1963 a net operating loss of \$152,147.20 and a deficit position of \$159,437.24. To complete the lamentable picture, financial statements of Mart

⁶Exhibit 1830.

⁷Exhibits 1830 and 1819.

¹Evidence Volume 39.

²Exhibit 2287.

Utilities at the same year-end date showed that this company also had joined its companions in insolvency, having borrowed \$566,705.49 from Commodore Sales Acceptance without any security having been given, and having suffered a net loss on operations for the year of \$27,127.23, which represented its total deficit after deduction of contributed capital of \$5. In this case assets of \$527,160.14 consisted of amounts receivable from Bond & Cosman which was itself insolvent, and in respect of which Mart Utilities made no apparent allowance for loss.³

The "Little Scot" Stores

Groship attributed the combined deficit of some \$867,000 of the three companies borrowing from Commodore Sales Acceptance, as at July 31, 1963, to the failure of Towers Marts & Properties, and suggested that the Towers operations in the United States were attempting revival by the siphoning-off of large sums of money from the Canadian company. He was at least successful in obtaining a compromise of leases under which Bond & Cosman was obligated to Towers Marts & Properties, and in returning the stock of the pet concessions to suppliers at invoice cost. It was otherwise with the inventory of the millinery and fabrics concessions and, after a conference with Morgan who adjured him to "keep working, we have to recoup, we have to make this money back", it was decided to store this material and dispose of it through the "Little Scot Close-Out Marts" to which some attention must now be given. Groship caused to be incorporated, by letters patent issued under the seal of the Secretary of State for Canada, a company called Highlight Distributors Limited on March 15, 1963 and he, his brother, and Mrs. Noel-Bentley became directors of this private company following the resignation of the provisional directors. It was used for the operation of the Little Scot Close-Out Marts where Groship's associate Irving Pomerantz was employed and in which he was promised a substantial share. Highlight Distributors also carried on business as a purveyor of musical instruments and accessories under the name of "Ingram & Roberts" and, according to E. N. Kemp,¹ Bon Ami Limited was permitted to pay at least some of the advertising expenses of this enterprise in Montreal.² Another private company was incorporated on January 24, 1963 under the name of Mart Buying Services Limited and by April 24 of that year Gerald Groship, David Groship, Irving Pomerantz and Mrs. Noel-Bentley had become directors, the 25 issued common shares being beneficially owned by Gerald Groship.³ Pomerantz said that this was a jobbing company which bought surplus stock and discontinued lines of merchandise and

³Exhibit 318.

¹Evidence Volume 57.

²Exhibit 3011.

³Exhibit 414.

OTHER MAJOR LOANS

sold them wholesale to various purchasers, including Highlight Distributors.⁴ Groship maintained that the operations of these companies were, in the early stages, not financed by Commodore Sales Acceptance and were not intended to be. The Little Scot stores, he said, were opened with the approval of Morgan and Woolfrey and added:⁵

"... I got to a point where I was so dissatisfied with the service I was getting out of the Walton, Wagman office, what they did they did properly but they were always too busy for me and when we opened the new company I asked Mr. Morgan for permission to change accountants and at that time we had Mr. Gilbert R. Barrett and Associates as our accountants for Highlight and for Mart Buying Services."

Still another company was incorporated under the name of Province-Wide Stores Limited on March 4, 1964 to operate a Little Scot store in Guelph, Ontario.⁶ That Morgan ever approved of these independent ventures must be doubted, and in any event, after seeing the financial position of the Bond & Cosman operations at July 31, 1963, he made it plain to Groship that the Little Scot group must be used to cover the losses suffered by Commodore Sales Acceptance to date; as Groship reported it, he wanted them "under one ball of wax".

Morgan's Plan to "Spread the Liability"

Both Groship and Graham Bartlett described the meeting which they attended with Morgan and Woolfrey at which Morgan described his plan for rescuing Groship and Commodore Sales Acceptance. All of the existing Groship companies would be merged with a new group of discount stores, each set up under a separate corporate organization "to spread his liability". Groship described the occasion as follows:¹

"I—we attended a meeting with Mr. Bartlett, Mr.—I attended a meeting with Mr. Bartlett and Mr. Morgan and Mr. Woolfrey on one occasion in which Mr. Morgan told us how he wanted the—since he had already taken over from Mr. Pomerantz that he wanted these things set up, and he gave us a number of good reasons as to why he wanted all these stores in separate companies, included in which he wanted to spread his liability, and I listened to it, we discussed it latterly. I didn't hear any more, I was out, and Mr. Samuel called me and said he had prepared agreements that would carry over my guarantee from the old company but there was a new set-up. In other words, that this—I wasn't being relieved by Mr. Morgan, sir, of my guarantee to his obligation. And I went down to Mr. Samuel, and I examined the papers and signed them and I have not heard any more about it till this hearing began and the information came from the hearing that this money had

⁴Evidence Volume 40.

⁵Evidence Volume 40, p. 5547.

⁶Exhibit 1159.1.

¹Evidence Volume 40, pp. 5527-47.

been transferred, and it was beyond my knowledge how it could be done because I didn't know of it until yesterday morning. I found out for the first time that I was no longer president of Bond & Cosman, Mart Utilities and Trans Canada. So in that case, of course, it could be done without me.

I found from Mr. Avery he read the dates out and that was the first time I heard about it.

Q. I see.

THE COMMISSIONER: Well on that point, Mr. Groship, were there any meetings of the directors of Bond & Cosman and Trans-Canada Millinery, Mart Utilities?

A. None that included me, sir.

Q. None that included you or of the ten stores in the Little Scot group including Highlight?

A. Not that included me, I had only one meeting on the subject with Mr. Morgan and I described it to you and I had a meeting with Mr. Samuel on the agreements and my contacts with the situation ended.

Q. There is a very pronounced absence of corporate records as no doubt you are aware here, do you ever remember seeing or signing any minutes in connection with any of these companies?

A. We signed the original minutes and we signed the original permission for bank loans.

Q. Yes.

A. But beyond that there wasn't. We had the permission to make loans and beyond that I know of no reason for us to be holding meetings.

Q. There was no annual meeting of shareholders held after the initial corporation?

A. I think we had an annual meeting, I am not quite sure, sir. If this is so might I suggest that it was only because I really didn't feel in control of the situation even though I was in fact president of the company since all the direction came from Mr. Morgan to such a degree and my holdings in it were so limited, they held—they had all the money in it, they held all the leases, they had all the assets under those circumstances running into such huge amounts of money I could really hardly feel a controlling factor in the company.

Q. Well now, whose decision was it to incorporate the discount stores as individual companies, that is Anglo, Jumbo, Saxon—

A. That came from Mr. Morgan, sir.

Q. All right. Under what circumstances was that decision communicated to you?

A. At this meeting as I described that was held with Mr. Woolfrey and Mr. Bartlett and myself.

OTHER MAJOR LOANS

Q. And who acted as solicitor for these companies?

A. I believe it was David Samuel handled all of that at that time, I think he handled them all."

Bartlett gave a more circumstantial account, saying that at this meeting it was decided by Morgan that the inventory of Bond & Cosman, Trans Canada Millinery Sales and Mart Utilities should be transferred to the new companies operating Little Scot retail stores, and that Commodore Sales Acceptance would lend to the latter the funds necessary to purchase the inventory, enabling the Bond & Cosman group to make repayments to Commodore Sales Acceptance out of the proceeds. David M. Samuel, who was retained to act for Commodore Sales Acceptance, took over the corporate records of the Province-Wide Stores and drew the necessary documents to reflect the resignation of the Groship directors and the election of Bartlett (who was to be president), Gerald A. Kraemer, Edmund G. Martin (employees of Arcan Corporation) and himself as the new board which thereupon enacted a by-law authorizing the execution of a debenture in favour of Commodore Sales Acceptance to secure inventory financing in the amount of \$200,000. At the same time Samuel obtained letters patent incorporating four Ontario private companies called Anglo Discount Sales Limited, Celtic Discount Stores Limited, Jumbo Discount Sales Limited and Saxon Discount Stores Limited, dated April 23, 1964, which was the date of the change of control of Province-Wide Stores. Each of these companies had the same directors as Province-Wide Stores and all of them held one share in each company's stock in trust for Commodore Sales Acceptance. Although Bartlett was president in name of all these companies, he said that, in fact, they were still managed by Gerald Groship from the offices of Arcan Corporation the address of which they shared, and Groship said that he remained in control of Highlight Distributors which had a contract to manage the Little Scot Stores at a fee of 35% of their gross sales out of which apparently all the expenses of operation, including wages, were paid; the Little Scot companies, however, purchased their inventory with money lent by Commodore Sales Acceptance.

The second schedule produced by Mr. Avery, and entered in evidence, is Table 54.² From this it will be seen that between April 15 and May 29, 1964 Commodore Sales Acceptance advanced \$711,616 to the five Little Scot companies then in existence which forthwith paid it to Bond & Cosman to the extent of \$480,603 and to Mart Utilities of \$231,013. On virtually the same days these two companies repaid the same amounts to Commodore Sales Acceptance. Mr. Avery's third schedule, Table 55,³ illustrates the transfer of inventory from Bond & Cosman and Mart Utilities to the five Little Scot stores, as exhibited by the

²Exhibit 2288.

³Exhibit 2289.

purchase journals of the recipients, compared with advances to them by Commodore Sales Acceptance which, in the case of the initial advances and transfers to Province-Wide Stores, Celtic Discount Sales, Jumbo Discount Sales and Anglo Discount Sales, are exactly \$100,000 more than the value of the inventory shown on the purchase journals of these companies. The result appears on the first schedule, Table 53, as a repayment of \$711,616 by the Bond & Cosman companies during the period ended July 31, 1964, together with additional repayment of \$333,299 derived from the transfer accounts against additional advances of \$795,096. The net reduction, however, in the debt owing by Bond & Cosman, Mart Utilities and Trans Canada Millinery Sales (which did not benefit from the Little Scot payments because of lack of inventory to transfer) was only \$93,511, through the addition of unpaid interest of \$156,308 to the capital amount of the loan which at July 31, 1964 amounted to \$1,276,268, due from the Bond & Cosman companies. The additional advance of \$720,650 to the Little Scot companies raised the total of advances made by Commodore Sales Acceptance to \$1,996,918.

Gerald Groship made still another attempt in the autumn of 1964 to operate independently, and in a manner which did not involve repayment of the large amounts of money advanced to his companies by Commodore Sales Acceptance which he had personally guaranteed. On September 28, 1964 Preston Lake Discount Stores Limited was incorporated by letters patent as a private company in Ontario, not by Samuel but by solicitors of Groship's choosing,⁴ and 49 common shares were issued to Groship, 50 to Pomerantz and one to Mrs. Noel-Bentley. Spadina Discount Stores Limited was incorporated in similar fashion on November 18.⁵ But Morgan once again stepped in to quell this uprising on the advice of Gilbert R. Barrett & Co., who sent the following letter to him on October 7, 1964:⁶

"Dear Mr. Morgan:

Enclosed please find a copy of the pro-forma statement of operations for the retail division of Highlight Distributors Ltd. setting out store expenses, estimated sales, gross profits, profit or loss, break-even sales total, and store opening dates. It is our opinion that this chain of stores could be profitable and pay the interest charges on the loan if certain steps are taken in controlling procedures, inventories, cash and in fact the entire operation.

In order to make clear to Mr. Groship that the entire operation, wholesale and retail, is one entity and that he is operating on your behalf, only until such time as he is relieved of his personal obligation to you, the following steps should be taken:

1. The shares in all Companies—Mart, Highlight, Spotlight, Preston Lake, etc.—should be endorsed over to your nominees.

⁴Exhibit 429.

⁵Exhibit 436.

⁶Exhibit 4930.

OTHER MAJOR LOANS

2. The Little Scot store at Queen and Spadina should be included in the whole chain of stores.
3. No business transactions whatsoever should be made by the individuals on the owner's behalf outside of the companies.
4. The accounting should be removed from the jurisdiction of Groship, Pomerantz and Bentley.
5. Mr. Groship should make all decisions on day-to-day operation of the business but no major changes should be made without the consent of yourself or your agents.
6. The financial obligation to creditors should be relieved and then removed from the present management's jurisdiction again, aside from day-to-day obligations, so that Mr. Groship can devote his time and effort to the management and operation of the stores, the field for which his abilities are best suited.
7. Grayme Bartlett or someone else of equal or better qualifications should be made comptroller and in charge of all finances, controls and office procedure.
8. Monthly profit and loss statements should be prepared so that management at all levels is on top of the situation at all times.
9. All purchases, cash or otherwise, should be supported by purchase orders and invoices and receipted debit slips.

There are many other details which can be gone into but in our opinion the important feature is to convince Mr. Groship that the whole operation is one and that he and his assistants are, in effect, salaried employees with the responsibility of placing the business on a profitable basis and with the potential of them owning the business completely at the time that you relieve Mr. Groship of his personal obligation.

We would suggest that the above recommendations be put to Mr. Groship as coming entirely from yourself, so that we can remain on terms with him, where he can feel that we are acting on his behalf. In the long run, if the business is profitable he will, of course, be in a highly improved financial position over his present situation.

Please contact our office if you desire any further information and if we can assist you in implementing our suggestions with Mr. Groship.

Yours very truly,

GILBERT R. BARRETT AND CO."

The records of the Preston Lake and Spadina companies were accordingly turned over to Samuel who, on November 26, was to incorporate the last of the Little Scot companies under the name of Golburn Discount Sales Limited.⁷ These three companies conformed to the usual practice of giving debentures to Commodore Sales Acceptance, but loans made to them were not guaranteed as to repayment by Groship who, as he

⁷Exhibit 3025.

stated in evidence, had become disenchanted by Morgan's efforts to pinion his wings and declined to execute further guarantees. Finally Kelton Ultrasonics Limited, a company incorporated in 1955 and a subsidiary of Arcan Corporation, had as its directors from November 20, 1962 until October 24, 1964 Gerald Groship (who was president), Walter Pahn and B. von Kalben. In the spring of 1964 it had joined with the dormant Chatsworth Enterprises to operate, under the trade name of "Ingram & Roberts", a music store in Toronto and another in Montreal, and on October 24 a new board of Bartlett, Martin and Kraemer was appointed, Kraemer being replaced on February 24, 1965 by Frank Cockburn. Perhaps because of the nature of their business, most of the financing of Kelton Ultrasonics and Chatsworth Enterprises was handled by Standard Discount Corporation, the wholly-owned subsidiary of Atlantic Acceptance Corporation, and the loans of Commodore Sales Acceptance at July 31, 1965 were in the moderate amounts of \$35,017 to Kelton and \$37,058 to Chatsworth.

It will be seen from examination of Table 54 and Table 55 that the same barefaced device of inflating the value of the inventory purchased by the original Little Scot stores by an even \$100,000, to enable the Bond & Cosman companies to repay Commodore Sales Acceptance, was resorted to in the case of those companies created during the fiscal year ended July 31, 1965. Table 53 shows that during this period the excess of advances by Commodore Sales Acceptance to the Bond & Cosman companies over repayments to them by the Little Scot companies, procured by advances to the latter from the same source, including interest partly accrued and partly capitalized, was only \$26,864, bringing the grand total up to \$1,303,132. This figure included two special advances to Bond & Cosman itself amounting to \$281,217 which are briefly examined below and which involved the employment of Bond & Cosman as an intermediary without any relation to the Groship operations. However, advances to the Little Scot companies by Commodore Sales Acceptance amounted to \$1,282,314, plus accrued and capitalized interest of \$104,241, against repayments of \$233,698. Thus the total sum outstanding and owed by the twelve Little Scot companies, operating and servicing ten discount stores situated in Toronto, Guelph, London and Windsor and two musical supply stores, one in Toronto and one in Montreal, reached a total at July 31, 1965 of \$1,873,507. No financial statements were prepared for the years ended at that date, but it may be asserted with some confidence that these companies, with no contributed capital other than possible payment for shares to qualify their directors, were at all times insolvent. The whole commitment of Atlantic funds by Commodore Sales Acceptance to these enterprises of Gerald Groship when they ceased to flow amounted to a staggering \$3,176,639.

Two Special Advances: Bond & Cosman Limited and Premiumwares Limited

Evidence about the advance by Commodore Sales Acceptance to Bond & Cosman of \$111,217, shown on Table 53 as "special advances re Molly Corporation", was given by Mr. Wolfman of P. S. Ross & Partners in connection with the affairs of Dalite Corporation and Daylite of Grand Bahama on September 22, 1966.¹ On December 31, 1964 Bond & Cosman Limited drew a cheque on its account in the Canadian Imperial Bank of Commerce in favour of "Dalite of Grand Bahama Co. Ltd." for \$103,487.84.² Daylite of Grand Bahama then paid out, on January 5, 1965, the sum of \$102,723.03 in U.S. funds and on the same day Dalite Corporation (Canada) recorded receipt from Daylite of Grand Bahama of \$110,266.75 in Canadian funds, evidently the Canadian equivalent, and deposited that amount in its transfer account at the Bank of Nova Scotia, from which payment could only be made to Commodore Sales Acceptance³ and out of which the transfer was duly made on the following day. Commodore Sales Acceptance issued a cheque to Bond & Cosman, dated January 5, 1965, in the amount of \$111,217.04 in Canadian funds. According to Mr. Wolfman's evidence, he had been informed by the trustee that 20,000 shares of Lucayan Beach Hotel Company had been found in the possession of Commodore Sales Acceptance and noted on the security listing as being "Bond & Cosman". However, Mr. Avery stated that the shares which were pledged by Bond & Cosman were those of Molly Corporation, and in subsequent correspondence with the Clarkson Company Limited they would appear to have been among those exchanged for shares of Adobe Brick & Supply after the sale of the assets of Molly Corporation to United Shoe Machinery Company. To make the matter somewhat more complicated, Commodore Sales Acceptance, in its ledger dealing with an account described as "special notes receivable Bond & Cosman Ltd.", as set up to record the transaction, identified the advance to Bond & Cosman, dated January 5, 1965, as "re Molly—Lucayan shares", and it will be recalled that the shareholders of Molly Corporation were given the right to buy one share of Lucayan Beach Hotel Company for each share of Molly held in the original hotel company underwriting. All attempts to make sense out of this transaction, in which funds of Commodore Sales Acceptance once again went around in a circle, have been fruitless, but since Commodore Sales Acceptance showed the payment from Dalite Corporation as having been made on December 31, 1964, it is possible that it constitutes simply another example of a switch in the identity of debtors to improve the appearance of Commodore Sales Acceptance's

¹Evidence Volume 62.

²Exhibit 3174.

³Exhibit 3176.

account with Dalite Corporation, although this explanation is not wholly convincing.

Another special advance shown on Table 53 to Premiumwares Limited in the amount of \$170,000 refers to a rather more complicated transaction in which Bond & Cosman was also used as an intermediary, probably because it possessed a permit to sell tangible personal property in Ontario as provided by section 3 of the Retail Sales Tax Act of Ontario.⁴ Some reference has already been made in Chapter XIII, dealing with the affairs of Valley Farm and Enterprises Limited, to the disposition of a debenture of Phantom Industries Limited which Valley Farm had bought and charged to expense. It was then seen that this circumstance was connected with the tangled affairs of one Harrison Verner whose company, Leland Publishing Limited, was in receivership and its two subsidiaries in bankruptcy. The Clarkson Company Limited was receiver and manager in the first case and trustee in the case of the two subsidiaries. Verner also presided over the affairs of Phantom Industries Limited, formerly known as National Hosiery Mills Limited, a company having its principal factory in Hamilton, Ontario and two others in the province of Quebec, which had also in 1964 been placed in receivership. The Hamilton property at 220 Dundurn Street South was encumbered by a first charge under a bond mortgage given to the National Trust Company as trustee, for which the Clarkson Company Limited acted as receiver and manager of Phantom Industries Limited, and a second mortgage to Adelaide Acceptance securing the sum of \$250,000. The Bank of Montreal was a secured creditor of the two companies subsidiary to Leland Publishing, holding, as its security, inventory, debentures and shares of the Leland companies, \$475,000 worth of debentures and 52,500 common shares of Phantom Industries, together with a promissory note of Harrison Verner for \$150,000, his personal covenants, those of his wife Esther, and of a company called Premiumwares Limited. A complex and comprehensive network of guarantees, involving all the debtors to the bank, had also been obtained. Bond & Cosman, backed by the copious resources of Atlantic Acceptance, was called into play to act as an instrument in the disentanglement of this affair, with the object of satisfying the bank and getting the Leland Publishing inventory back into the hands of Verner through Premiumwares. The task of attempting to simplify the manner in which this was done is an unenviable one, and it may be found treated at great length in a letter, dated April 5, 1965, addressed to Premiumwares by David M. Samuel in which he reports on it with elaborate care in the course of some twenty pages, and another letter from the same solicitor, dated September 1, 1965, to Messrs. Tory, Tory, DesLauriers & Binnington acting for the Clarkson Company Limited in which he offered further explanation of the report of April 5.⁵

⁴9-10 Elizabeth II, c. 91.

⁵Exhibit 1160.

OTHER MAJOR LOANS

Part of the second letter reads as follows:

"In November 1964 Bond & Cosman Limited, a company wholly owned and controlled by Commodore Sales Acceptance Limited, acquired the inventories of books, plates, and films and the office, warehouse and shipping room equipment of Leland Publishing Limited from the Bank of Montreal and The Clarkson Co. Limited. They subsequently acquired the Phantom Industries Limited building in Hamilton from Adelaide Acceptance Limited and the balance of Adelaide's unsecured claim against Phantom Industries Limited.

In December 1964 Premiumwares purchased these assets from Bond & Cosman for the sum of \$690,000.00, all of which was loaned from Commodore Sales under an agreement dated December 7th, 1964. Commodore Sales received a \$350,000.00 portion of a \$400,000.00 five year 8½% debenture covering the inventories acquired (the remaining \$50,000.00 portion of the debenture went to Mrs. Esther Verner who advanced that amount into Premiumwares for working capital purposes). Commodore also received a \$170,000.00 first mortgage bearing interest at the rate of 6% per annum and running for five years, secured against the building in Hamilton. Due to title difficulties this mortgage was never registered but merely held on hand in my file. The balance of the loan, in the amount of \$170,000.00, was represented by an unsecured interest free five year note.

When the building and balance of Phantom debt had been sold by Adelaide to Bond & Cosman the purchase price was adjusted so that Adelaide would not show any loss on a previous loan that it had made to Phantom. In fact it was estimated that the loss might amount to \$170,000.00 and this amount was therefore tacked on to the sale price and carried forward in the subsequent sale price between Bond & Cosman and Premiumwares. In securing this portion of the loan from Commodore Sales though, Premiumwares insisted that this amount would be unsecured and free of interest. The parties felt that the inventories would throw off a profit of at least \$170,000.00 and they intended that this amount would be used to take care of the anticipated loss that Adelaide was facing (and which was now transferred to Bond & Cosman and Commodore Sales).

It was intended that Premiumwares would sell the inventories and the building and probably would realize no profit on these sales as it was anticipated that these sales would be sufficient to cover Commodore's loans and not much more. There was, however, the off chance that more profit would be generated, in which case Premiumwares would be entitled to this profit. The transaction was advantageous in that Commodore Sales could help to recoup an almost certain loss being faced by Adelaide, a fellow subsidiary company of Atlantic. From Premiumware's point of view the transaction was advantageous in that the company was enabled to obtain the release of various articles of security from the Bank of Montreal, including the compromising of various outstanding debts and guarantees given by it and Harry Verner, its president, and in addition the company was enabled to establish itself in business once again.

The debenture permitted the sale of the inventories in the usual course of Premiumwares' business and it was agreed that 65% of the proceeds of sales would be paid in reduction of the debenture and the remainder retained for working capital purposes. These percentages had been merely pulled out of a hat on a guess by Mr. Verner as to what he would require for working capital and in fact he later realized that a greater percentage of the sale proceeds would be required. Mr. Woolfrey of Commodore Sales agreed to allow him to retain more of the funds. This debenture is registered in the name of Theodore Sherman, Trustee, however the terms of the trust agreement under which he holds same gives Commodore Sales effective control.

In the event of the sale of the building it was also agreed that Premiumwares would not realize any of the proceeds until after the payment of all outstanding accounts and expenses properly incurred in the course of the operation of the building and the sale thereof, and also the satisfaction of the \$170,000.00 mortgage. The agreements were drawn so that if there was an excess of proceeds after the expenses were paid and the \$170,000.00 mortgage retired, then such excess was to be applied to the unsecured interest free note; however after an agreement of purchase and sale was entered into and it was realized what the excess would amount to, Mr. Woolfrey and Mr. Verner agreed that the excess should be applied to the debenture loan and that the \$170,000.00 interest free note would be repaid after the debenture was retired.

In the agreement of purchase and sale between Adelaide and Bond & Cosman the purchase price included the sum of \$6,500.00 as being an estimated amount that might be required to discharge two mechanics' lien claims and a writ of execution which were filed against the title to the lands in Hamilton. It was agreed that in the event the total cost of removing these claims was less than this amount Adelaide would repay the difference to Bond & Cosman. In the subsequent agreement of purchase and sale between Bond & Cosman and Premiumwares this term was also included. I have not as yet completed the removal of these encumbrances from title but it is apparent to me that the cost of doing so will be considerably less than \$6,500.00 and since the purchase price to Bond & Cosman was inflated so as to avoid any loss on the books of Adelaide, and the over statement of the value is reflected in the \$170,000.00 unsecured note given back by Premiumwares to Commodore Sales, it has always seemed to me that the only fair thing is to reduce Premiumwares' obligation to Commodore Sales by whatever amount less than \$6,500.00 is required to settle these claims. This same treatment, in my opinion, should be given to the sum of \$321.19 which was overpaid to Adelaide on the closing of the sale with Bond & Cosman when adjustment figures were not available. This sum was subsequently overpaid to Bond & Cosman by Premiumwares and after adjustment figures were available a request for the money was made to Adelaide but somehow the item was forgotten about.

In reviewing this series of transactions I would suggest that you consider Bond & Cosman Limited as a conduit pipe between the various

OTHER MAJOR LOANS

parties. It had a tax loss position which could take care of any profits that might accrue and it was also the holder of a vendor's permit under the Retail Sales Tax Act, however it was never really a party to any of the transactions but merely acted in a trustee capacity.

On page 18 of my report of April 5th last I advised you that Mr. Theodore Sherman and myself had directed Mr. Woolfrey to elect to accept settlement in the Phantom Industries Limited bankruptcy, in accordance with alternative (b) of the proposal, in respect to \$475,000.00 worth of unsecured debentures which he had lodged with him. These securities together with 52,500 Phantom common shares had been released by the Bank of Montreal when it sold the Leland inventories back to Mr. Verner. In order to control the inventories and thus secure the monies being advanced by Commodore Sales to acquire these inventories, title was taken in the name of Bond & Cosman until agreements could be prepared and executed. In taking title to the inventories Bond & Cosman also took possession of the Phantom debentures and common shares. These securities and shares had no real value at the time they were returned by the Bank of Montreal but, of course, there was a possibility that they would one day be worth something. They at no time formed any part of the parties' consideration when the matter of security for the loans being made was being discussed however they were left with Mr. Woolfrey under no specific arrangement but as a sort of pledge of good faith by Mr. Verner to justify the faith and funds that Commodore had invested in him and his company. Once Commodore was repaid there is no doubt in my mind that all the securities were to be returned to Mr. Verner and even if the project was not successful I believe it was the intention that Mr. Verner would retain the securities once the project was completed. When it became necessary to vote the debenture in Phantom's proposal they were registered in Mr. Woolfrey's name so that this could be done and, as stated in the report, a letter of direction was sent to him from both Mr. Sherman and myself instructing him to vote in favour of the proposal."

The price paid by Bond & Cosman, acting as nominee for Harrison and Esther Verner, to the Bank of Montreal in November 1964 was \$505,000, of which \$285,000 was paid in cash with the balance of \$220,000 payable under an interest-free promissory note also signed by Leland Publishing, Premiumwares and the Verners. Bond & Cosman paid a further \$64,510 on November 26 to the Clarkson Company for additional inventory, so that the total cash required by it amounted to approximately \$350,000 which it borrowed in November from Adelaide Acceptance, also without contracting to pay interest. Then, on December 3, Bond & Cosman bought the Phantom Industries building at 220 Dundurn Street for \$220,000 and the balance of an unsecured claim by Adelaide Acceptance against the estate of Phantom Industries for \$120,000; this transaction was closed on December 23 by a cheque made payable to Adelaide Acceptance in the amount of \$340,000. Thus

Adelaide was able to show at the year ended December 31, 1964 that its account receivable from Phantom Industries at the previous year-end, amounting to \$327,823.09, had been repaid;⁶ as Samuel pointed out, the purchase price was deliberately inflated to enable it to do so and to recover an estimated \$170,000 loss on this account. On December 23 Bond & Cosman sold 220 Dundurn Street South to Premiumwares for \$220,000, the unsecured claim against the estate of Phantom Industries for \$120,000 and the inventories and assets acquired from the Bank of Montreal and the Clarkson Company Limited for \$350,000, for a total price of \$690,000, all of which was provided by Commodore Sales Acceptance⁷ by a payment of that amount to Bond & Cosman, which in turn paid it to Adelaide Acceptance on the same day in the amount of \$340,000, already mentioned, and a further \$350,000 in repayment of the Adelaide loan. This was treated as a payment in cash of \$520,000 by Premiumwares and the balance of \$170,000 as owing under a promissory note from that company in favour of Bond & Cosman, collaterally secured by an assignment of the Adelaide Acceptance claim against the estate of Phantom Industries, having a face value of \$165,341.28 and purchased by Premiumwares for \$120,000. This security and the promissory note for \$170,000 were pledged to Commodore Sales Acceptance by Bond & Cosman, and the former also received a mortgage of the Hamilton property to secure \$170,000 with interest at 6% per annum. Premiumwares had thus recovered the assets of the Leland Publishing firm by borrowing against a debenture, a first mortgage and an unsecured five-year note, not bearing interest, described in the second paragraph of Samuel's letter quoted above. By June 30, 1965 the building had been sold and some payment made on the debenture, the Clarkson Company Limited showing an amount owing to Commodore Sales Acceptance of \$452,488;⁸ the amount receivable from Premiumwares at June 17, 1965 was shown by the Commission's accountants as \$499,534.10,⁹ evidently including unpaid interest. The Clarkson Company, because of Verner's swift re-establishment in the business of providing premiums and books to department stores and the insignificance of the assets of Premiumwares, decided to hold its hand, and spent many months working out a settlement eventually achieved in June of 1966. Since the \$170,000 represented by the interest-free promissory note had been a liability forced upon Premiumwares to save the face of Adelaide Acceptance, which had expected to suffer loss in this amount from having taken a second mortgage on 220 Dundurn Street South instead of a first mortgage as it thought, it was decided to

⁶Exhibit 584.

⁷Exhibit 2308.

⁸Exhibit 5124.

⁹Exhibit 578.

OTHER MAJOR LOANS

excuse Premiumwares from payment of this part of the debt if quarterly payments were made on the debenture. The compromise reached in June 1966 required repayment of a total of \$195,000 and full recovery is expected.

The Last Word

The loans made by Commodore Sales Acceptance to the Bond & Cosman and Little Scot companies and the nature of the security held by the lender are illustrated on Table 56.¹ It will be seen that when Mr. Avery prepared this exhibit in May 1966 the estimated recovery on loans amounting to \$3,176,639 was only \$69,000. Subsequently, on July 16, 1968, the Clarkson Company advised the Commission that liquidation of all the assets of these bankrupt companies, of which it was trustee, was virtually complete, and its current estimate of the deficiency was \$3,064,992.92 with only some \$500 in doubt. Of this amount only the \$251,153 owing by Bond & Cosman in respect of the special loans above described is not attributable to the frantic business operations of Gerald Groship. Woolfrey could not have been exaggerating the situation when he said:²

“Mr. Morgan was more than somewhat annoyed at Mr. Walton for introducing him to Mr. Groship. He said it wasn’t a very good day when he got himself involved with this loan.”

4

The Symphony Paint Company and Jacroy Canada Limited

At June 17, 1965 an Ohio corporation by the name of The Symphony Paint Company owed Commodore Factors Limited \$1,557,692,¹ stated by the receiver and manager of Atlantic Acceptance Corporation to be an even \$1,600,000 at June 30.² Evidence as to the history of this loan and the activities of the company and its Canadian affiliate, Jacroy Canada Limited, was given by Mr. David E. Langman C.A. of Touche, Ross, Bailey & Smart before the Commission on September 29, 1966.³ The American company, originally known as the Jacroy Company, was incorporated in the State of Ohio as a private company on August 29, 1947 with an authorized capital of \$15,000, subsequently increased on February 7, 1955 to provide for 3,500 common shares of no par value and 1,000 preference shares having a

¹Exhibit 2290.

²Evidence Volume 102, p. 14062.

³Exhibit 581.

²Exhibit 5124.

³Evidence Volume 66.

par value of \$100 each. It was engaged in manufacturing and distributing paint from premises in Bedford, Ohio, a suburb of Cleveland. Jacroy Canada Limited was incorporated as a private company in Ontario on January 5, 1953, with authorized capital subsequently fixed by supplementary letters patent, dated December 4, 1963, at 1,350 preference shares with a par value of \$100 each and 25,000 common shares of no par value, but with consideration limited to \$25,000.⁴ This company conducted its business from premises at 421 Comstock Road in the Township of Scarborough. By 1961 both companies were controlled by J. George Meckler and Maurice J. Lazar, who will be remembered as vendors to C. P. Morgan of a controlling interest in the shares of Aurora Leasing Corporation Limited⁵ and who continued to carry on a leasing business in Montreal and Toronto through Corporate Plan Leasing Limited. The name of their Ohio company was changed on October 5, 1962 from the Jacroy Company to the Symphony Paint Company.

The earliest documentary evidence of the lending of Atlantic funds is to be found in the form of a handwritten memorandum⁶ identified by Carl M. Solomon as "notes of a meeting held on November 13, 1961" of Morgan, Meckler and himself to arrange an Atlantic loan to the Jacroy Company in Ohio. A draft agreement⁷ referred to a loan of \$250,000 in U.S. funds at 12% per annum. The final agreement⁸ provided for a loan of \$350,000 at the same rate with monthly payments of interest and quarterly repayments of principal over a period of five years. The shareholders of the Jacroy Company were represented by Meckler, Lazar and R. A. Treter, all of Cleveland, holding collectively 3,080 of the 3,310 issued shares of the company, and the agreement was executed by the Jacroy Company, M.L.B. Investments Limited, an Ontario company owning the premises occupied by Jacroy Canada Limited which also signed, J. G. Meckler, M. J. Lazar, R. A. Treter and Commodore Factors Limited. Elaborate provision was made for securing the advances to be made by Commodore Factors, beginning with a series of promissory notes to be endorsed by Meckler and Lazar, and the lodging, pursuant to an escrow agreement with the Canada Trust Company, of 3,077 common shares of the Jacroy Company heretofore held by Meckler, Lazar and Treter, 2,000 common shares of M.L.B. Investments and their 215 common shares of Jacroy Canada, plus 182 to be released from an existing trust agreement, and 324 held by the Jacroy Company; no less than six insurance policies, of which the Lincoln National Life Insurance Company had issued two on the life of Meckler and one on that of Lazar, and the Continental Assurance Company three

⁴Exhibit 409.

⁵Chapter V, pp. 146-7.

⁶Exhibit 893.1.

⁷Exhibit 893.2.

⁸Exhibit 911.

taken out by the Jacroy Company on the life of Meckler, were assigned in all of which Commodore Factors was to be designated beneficiary. Although the available copy of the agreement was undated, it was executed on December 8, 1961, according to a letter from Solomon & Samuel reporting to Commodore Factors and dated March 28, 1962.⁹ Three of the insurance policies referred to in the agreement were evidently, and according to this letter provided by the Lincoln National Life Insurance Company, fully endorsed to Commodore Factors as beneficiary, two of which insured the life of Meckler for a total of \$250,000 and one the life of Lazar for \$200,000.

The Breach with Meckler and Lazar

On February 14, 1962, which was the date of closing, this loan of \$350,000 was, pursuant to direction, disbursed to pay a debt of the Jacroy Company to National Acceptance Corporation of Chicago in the amount of \$168,567.54. The sum of \$163,392.87 was retained to discharge short-term loans made to Meckler in anticipation of arrangements set forth in the agreement, as was \$1,750 to provide for possible fluctuations in the rate of exchange, and the balance of \$16,289.59 was remitted to the borrower. If Woolfrey's recollection is not at fault, difficulties occurred in the relationship between Meckler and Morgan shortly thereafter, caused by Morgan's belief that the value of the inventory had been overstated on the Jacroy Company's financial statement furnished to Commodore Factors, and as a result Meckler was asked to resign as president in favour of the company's sales manager, Leonard D. Koryta. According to the Solomon firm's file,¹ default in the required payments occurred on July 15, 1962 and documents were drawn to secure the 3,077 common shares of the Jacroy Company, 2,000 common shares of M.L.B. Investments Limited and 539 common shares of Jacroy Canada from the Canada Trust Company; but a letter from the Jacroy Company's Cleveland attorneys dated August 29, 1962, addressed to C. P. Morgan, indicates that, notwithstanding the dispatch of notices of default to Meckler, Lazar and other parties, Commodore Factors had held its hand and contemplated a reorganization of the Jacroy Company to ensure confirmation of Koryta as president, the change of its name to the Symphony Paint Company and the permanent exclusion of Meckler and Lazar from its management.² On October 5 the change in the company's name was secured and minutes were drawn as of that date to reconstitute the board of directors in accordance with Morgan's instructions.

The original loan agreement of December 8, 1961 provided that upon default Commodore Factors, in addition to becoming entitled to

⁹Exhibit 911.6.

¹Exhibit 911.

²Exhibit 911.

the shares held by the Canada Trust Company, was to be furnished with those of Meckler, Lazar and Treter qualifying them as directors of the Jacroy Company, M.L.B. Investments and Jacroy Canada, so that their resignations could be enforced. Commodore Factors also could elect to accept all the shares in full satisfaction of the Jacroy debt, or sell them privately or by auction and sue the company and its guarantors for the balance owing and for damages. Solomon, Singer & Rosen gave their opinion to Harry Wagman in a letter dated November 2, 1962³ and advised "a *bona fide* sale of these shares to be made by Commodore Factors Limited to a third party"; thus any claim of Meckler and Lazar to recover their shares would be defeated, judgment would in due course be obtained against them, so that they would be "concretely indebted" to Commodore Factors, and the latter, "or a third party working in conjunction with Commodore Factors Limited", would be in a position to attempt the rejuvenation of the borrower without interference from Meckler or Lazar. The threat of this action was sufficient to produce a compromise set forth in a document entitled "Acknowledgment, Authorization, and Release", addressed to Commodore Factors by Meckler and Lazar in which they consented to the sale of all the pledged shares by private contract for a sum of at least \$20,000 to be applied against the existing debt, which they acknowledged to be in the amount of \$332,399.79, and undertook to furnish a promissory note for \$312,399.79 payable to Commodore Factors one year after the date of making. It was further provided that any amounts realized on the assigned insurance policies could be credited against the liability of Meckler and Lazar who would retain their right to claim over against the Jacroy Company the sum of \$15,000 as the value attributed to the pledged shares owned personally by them. The release contained in this document not only included Commodore Factors, the Jacroy Company (except as aforesaid), Jacroy Canada, and M.L.B. Investments, but also C. Powell Morgan and Harry Wagman, and the appearance of their names among the parties in this document, which was executed on January 3, 1963, must be regarded as significant. This compromise was not arranged without the expression of misgivings on the part of Koryta who was anxious, because of past experience, to make a clean break with Meckler and Lazar, and he concluded a letter of March 15, 1963 to Carl Solomon by saying, "I might further state to you that the course that we offer now is a very good one from an accounting standpoint as we have a whopping big tax loss and our presentation of this handling would certainly not hurt us with the tax bureau as we appear as white lambs and are righting the wrongs that were done in the past".⁴ What he was referring to, and what continued to be the trend in subsequent years, may best be illustrated by reproducing

³Exhibit 911.

⁴Exhibit 911.

OTHER MAJOR LOANS

Mr. Langman's comparative statement of the financial position of the Symphony Paint Company for the years 1961 to 1965 inclusive.⁵

<u>Exhibit Nos.</u>	<u>103</u>	<u>100</u>	<u>101</u>	<u>102</u>	<u>3194</u>
	<u>December 31</u>				
	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
	<u>(unaudited)</u>	<u>(unaudited)</u>	<u>(audited)</u>	<u>(audited)</u>	<u>(audited)</u>
Current assets					
Cash.....	\$26,145	\$10,146	\$ 692	\$ 765	\$ 17,099
Accounts receivable					
—trade (net).....	168,816	34,442	115,176	141,958	92,479
—employees.....	73,538	13,831	906	699	410
Receivable from Jacroy (Canada) Ltd.....	(13,832)	(523)	12,306	71,008	—
Inventories.....	569,495	298,590	255,846	268,772	173,822
Prepaid expenses.....	31,563	5,831	17,553	27,677	20,685
Total current assets.....	855,725	362,317	402,479	510,879	304,495
Current liabilities:					
Accounts payable and accrued.....	256,777	134,490	72,272	79,169	94,922
Notes payable National Acceptance.....	134,186				
Loans payable Commodore Factors Limited (including non-current portion).....		571,070	932,012	1,322,971	1,503,062
Other.....	137,829	103,134	102,679	108,713	93,679
Total Current liabilities...	528,792	808,694	1,106,963	1,510,853	1,691,663
Working capital (deficiency)...	326,933	(446,377)	(704,484)	(999,974)	(1,387,168)
Fixed assets, at cost (net).....	169,259	166,071	168,602	176,747	178,554
Development costs.....			55,747	55,746	55,746
Other assets.....	27,800	17,692	15,927	17,509	6,819
	197,059	183,763	240,276	250,002	241,119
Non-current liabilities					
Advances from shareholders.	237,430	175,910	14,035	14,035	14,035
Chattel mortgage, National Acceptance.....	129,518				
Other liabilities.....	59,829	36,911	48,691	28,892	14,650
	426,777	212,821	62,726	42,927	28,685
Total liabilities in excess of total assets.....	(\$97,215)	\$475,435	\$526,934	\$792,899	\$1,174,734
Represented by					
Deficit.....	\$20,740	\$593,390	\$644,889	\$910,854	\$1,270,689
Less—capital stock.....	(95,955)	(95,955)	(95,955)	(95,955)	(95,955)
—application for preference shares...	(22,000)	(22,000)	(22,000)	(22,000)	—
	(\$97,215)	\$475,435	\$526,934	\$792,899	\$1,174,734

It will be noted that the position in 1963 and thereafter was considerably improved by the forgiveness of \$158,922 in loans formerly held to be payable by the company to Meckler and Lazar.

One of the objections raised by Koryta in his letter of March 15 was the failure of the acknowledgment, authorization, and release of

⁵Exhibit 3217.

January 3, 1963 and, indeed, of the loan agreement of December 8, 1961, to secure for Commodore Factors the preference shares in the two Jacroy companies held by Meckler and Lazar and members of their families. This was only briefly referred to in Koryta's letter of March 15, because he had gone into the matter at some length in a letter written to C. P. Morgan on March 4, copies of which had been sent to Harry Wagman and Carl Solomon,⁶

"... Not being an expert on Canadian law but having some knowledge of the preferred stock set up in the United States, I wish to point out that the preferred stock as held and listed below by Meckler and family and Lazar and family are preferred as to dividends, preferred as to assets and preferred as to voting rights. Therefore, even though we would strip them of their common shares, they would at some future date participate in the upgrading of these combined enterprises. I will list below preferred shares that are held and in the respective company:

Jacroy Bedford — M. J. Lazar	143	Preferred shares
Marjorie Lazar	316	" "
J. G. Meckler	43	" "
Fan W. Meckler	162	" "
Roy S. Meckler	55	" "
Norman Weinberger (son-in-law)	55	" "
Jacroy Canada — M. J. Lazar	48	Preferred shares
Majorie Lazar	60	" "
J. G. Meckler	109	" "

Perhaps this has been the very thing that has spurred Maury on in his various conversations with me in his demand for a statement because in truth if he holds these preferred shares he is entitled to a statement and perhaps this is the foundation that George is using to spread around his gospel of righteous indignation. I think this is a matter which should be culminated and woven into the fabric of your new release along with several other points which I think should now be cleared up. I personally feel that if this is not accomplished at this time we will be talking about this not only this year but next year and the following year at some stage. Now is the time in my opinion to right all the wrongs of the past and get these gentlemen completely out of the picture."

Koryta went on to say that the creditors of the Symphony Paint Company, with whom he had been negotiating for a settlement of claims, would take it ill if they knew that Meckler and Lazar still held preference shares, "as this has been a constant recurring problem". If, as this letter indicates, the release by Meckler and Lazar had been prepared but not yet signed, the date of January 3, 1963 eventually inserted must have been a conscious misrepresentation. However that may be and for

⁶Exhibit 911.

OTHER MAJOR LOANS

whatever reason, Koryta's advice was not taken at the time, but his intervention serves to introduce what appears to have been the central problem in the Symphony Paint transactions—the long drawn-out process of getting all the shares of the three companies which were available out of the hands of Meckler and Lazar and into those of Commodore Factors ostensibly, and those of C. P. Morgan and Harry Wagman in fact. Although it might seem to have been easy to deal with the common shares registered in the name of the Canada Trust Company in trust for Commodore Factors in view of the default in July 1962, the company's stock certificate book shows that the transfers of 3,077 shares out of the name of the trust company and the qualifying shares of Meckler and Lazar were not undertaken until September 22, 1964, and the recipient of the 3,079 shares was Carl Solomon as trustee. Solomon was questioned about his status in this transaction which, at the time he gave his evidence in September 1966, was only two years old and his answers at this point in his examination leave something to be desired.⁷

"Q. Now, Mr. Solomon, for whom were you holding these shares, 3079 in all, in trust?

A. Mr. Cartwright, I don't know, sir. I think the shares were transferred into my name as trustee at the request of Mr. Morgan after, if I remember correctly, an acknowledged default by the Symphony Paint Company on a loan made to it, I think, by Commodore Factors or Commodore Sales, one of the two.

THE COMMISSIONER: Well, one would have thought, looking at the document, that on default Canada Trust would have merely turned over the shares that were placed with them as trustee, to the beneficial owner entitled, which would be Commodore Factors Limited?

A. Yes, sir.

Q. And perhaps this was done, but in any event, subsequently the shares are deposited with you as trustee?

A. Yes, sir. I would have imagined, sir, they were deposited with me as trustee, to my knowledge, for obviously the lender of the money, Commodore Factors in this case, but I was instructed to put the shares in my name as trustee. I don't recollect that a declaration of trust was made out by myself for anyone in particular. I would assume that it was for Commodore Factors Limited."

One share remained registered to Treter, vice-president of Symphony Paint, and 230 to Marvin J. Laronge, a member of the Cleveland firm of attorneys which represented the company.⁸ On the day of this transfer 774 of the preference shares owned by the Meckler and Lazar families, and 14 owned by Mrs. Treter, were also transferred to Solomon,⁹

⁷Evidence Volume 66, pp. 9001-2.

⁸Exhibit 3211.

⁹Exhibit 3214.

leaving 155 distributed among Russell A. Treter, his wife, Laronge, and Pauline and Louis Potochnick. It is not clear from the available evidence exactly how the previous owners of these shares were induced to part with them, since they do not appear to have been pledged at any time, but there are indications of a long correspondence between Meckler and Wagman to whom the shares were eventually turned over.

Wagman Assembles the Shares

The 539 common shares of Jacroy Canada held by the Canada Trust Company in trust for Commodore Factors, together with the single shares qualifying Meckler and Lazar as directors, had been transferred to Wagman almost a year before on October 23, 1963.¹ Of these 217 shares had belonged to Meckler and Lazar, and 324 to Symphony Paint. In August 1963 Herman L. Blum, the third partner with Meckler and Lazar in M.L.B. Investments, sold to Wagman 182 common and 182 preference shares of Jacroy Canada, 1,003 common shares of M.L.B. Investments, demand notes made payable to himself by Jacroy Canada representing \$12,650 and one payable to M.L.B. Investments by the Jacroy Company for \$22,000, all for \$15,000 for which he was eventually paid by a cheque drawn on September 26 on the Trio account at the Guaranty Trust Company of Canada. The acquisition of common and preference shares of Jacroy Canada had actually commenced early in 1962 and the mere recital of what happened requires an explanation which cannot be supplied. A letter from Robert L. Lewis, of Symphony Paint's Cleveland attorneys, to Carl M. Solomon dated January 15, 1962² refers to the intention of Meckler and Lazar to buy Jacroy Canada shares from other shareholders with funds to be provided by C. P. Morgan or one of his companies. On March 16 of that year the notes receivable ledger of Aurora Leasing Corporation³ recorded advances of \$44,220, and \$2,183.36 designated as exchange, to J. G. Meckler and M. J. Lazar, and a promissory note for \$44,441.10 in U.S. funds, dated March 16 and due on May 31, 1962, bearing interest at 12% per annum was found in Wagman's file entitled "Aurora re Meckler and Lazar".⁴ On the back of the note there is writing, in a hand similar to that of Wagman, indicating a price of \$25 for the common and \$100 for the preference shares of Jacroy Canada and a reference to notes representing \$11,200. Solomon reported to Aurora Leasing on April 2, 1962 on this transaction, enclosing 264 common and 264 preference shares in negotiable form for safekeeping. No interest or principal was apparently paid by Meckler and Lazar, for on October 1, 1962 they executed a new demand note for \$51,515.32 and this amount, without variation, was

¹Exhibit 248.

²Exhibit 853.1.

³Exhibit 929.

⁴Exhibit 1635.

apparently outstanding at the date of the bankruptcy of Aurora Leasing on July 30, 1965.⁵ The trustee reported in 1966 that it was suing Meckler and Lazar on this note and was not aware of any defences available to them. In any event, Harry Wagman, in whose office the affairs of Aurora Leasing were managed, and for whose benefit Meckler and Lazar evidently set about acquiring the Jacroy Canada shares, by the end of 1963 had in his hands, and in his name, 987 of the 1,296 issued common shares and 446 of the 972 issued preference shares of Jacroy Canada, but had been unable to obtain 109 preference shares belonging to Meckler and 48 to Lazar, since these were held at the Yonge and Gerrard Streets branch of the Toronto-Dominion Bank in Toronto as security for loans.⁶

C. P. Morgan's Beneficial Ownership of the Symphony Paint Shares

A return must be made to the evidence of Carl Solomon as to his position as trustee, in succession to the Canada Trust Company, for the 3,979 common shares of the Symphony Paint Company registered in his name. The following document, dated April 22, 1964, was put to him by Mr. Cartwright:¹

"To: Carl M. Solomon,
c/o Messrs. Solomon & Singer,
44 King Street West,
Toronto 1, Ontario.

Re: Sale of 780 common shares of
Symphony Paint Company to Leonard D.
Koryta and Max J. Lang — Agreement
dated December 4th, 1963

Having appointed you as my Trustee to hold certain common shares in the capital stock of Symphony Paint Company in trust for me, and I having agreed to enter into an agreement of purchase and sale and an agreement of option with Messrs. L. D. Koryta and M. J. Lang in respect to the sale of a total of 780 of the said shares and in respect to the option to them of an additional 780 of the said shares, I hereby irrevocably authorize and direct you to execute on my behalf the agreement aforesaid and to take such further and other steps as may be necessary or requisite or as you in your opinion deem advisable to effect a transfer of the said shares in accordance with the terms of the agreement aforesaid and to hold such other of the said shares in reserve for the options given as aforesaid.

DATED at Toronto this 22nd day of April, 1964.

Witness:

'B. L. McFadden'

'C. Powell Morgan' "

⁵Exhibit 587.

⁶Exhibits 1635 and 3230.

¹Exhibit 3235.

The examination then continued:²

“Q. Was this a direction to you by Mr. Morgan as the beneficial owner of certain common shares of the capital stock of Symphony Paint Company?

A. Yes, sir, it is or it purports to be.

Q. I’m sorry, sir?

A. Yes, it purports to be, sir.

Q. And this deals with the two transfers of 12½ per cent each to Mr. Koryta and Mr. Lang, totalling 780 shares?

A. Yes, sir.

THE COMMISSIONER: Are these not part of the shares that were surrendered by Canada Trust Company to Commodore Factors on default on the note for \$350,000?

A. I think they were, sir.

Q. Well, does it not follow then that in respect of all those shares you must have been trustee for Mr. Morgan?

A. Well, sir, I think that in effect I was trustee for Commodore Factors, and it would appear that—I think Commodore Factors Limited, yes—it would appear that prior or during or between the time of my appointment as trustee or holding the shares for Commodore Factors and this transfer, I assume that in some way or other Mr. Morgan acquired ownership of these shares to effect the sale and the option.

Q. It would be fair to say that if this were the only evidence touching on the point I would be justified in assuming that you had always been Mr. Morgan’s trustee but that you now tell me that as far as you can recollect originally you were standing in the same position vis-à-vis Commodore Factors as Canada Trust had stood.

A. Yes, sir.”

Counsel then put to the witness, among other documents, a carbon copy of his letter of June 22, 1964 addressed to C. P. Morgan, reporting upon the sale of shares of Symphony Paint to Koryta and Lang, “on your behalf and on your instructions”, and another of the same date in 1965, in Morgan’s handwriting and initialled “C.P.M.”,³ reading

“Dear Carl

Please transfer the Paint trust shares to Len.”,

—a direction which Solomon thought must have been incorrectly dated and referred actually to June 22, 1964. If it did, it makes little sense in view of the explicit direction of April 22 referring to a transfer to both

²Evidence Volume 66, pp. 9008-9.

³Exhibit 3236.

OTHER MAJOR LOANS

Koryta and Lang; it is more probably correctly dated in 1965 and reflects ill-considered action taken only a week after the Atlantic default. Eventually Solomon received a direction executed on an unspecified day in August 1965⁴ in formal terms and beginning:

“Having appointed you as my trustee to hold certain common and preference shares in the capital stock of The Symphony Paint Company in trust for me I hereby irrevocably authorize and direct you to deliver all common and preference shares certificates in the capital stock of The Symphony Paint Company (formerly known as The Jacroy Company) to the Clarkson Company Limited”

The examination concluded as follows:⁵

“MR. CARTWRIGHT: Mr. Solomon, referring to Exhibit 3238, would I be correct in assuming, sir, that this was the last direction given to you by Mr. Morgan as the beneficial owner of the shares, to transfer the balance of the common and preferred shares held in your name to the Clarkson Company Limited?

A. Yes, sir, I think so.

THE COMMISSIONER: Even though you considered yourself to be the trustee for Commodore Factors, it certainly does not look as if Mr. Morgan thought you were?

A. At this stage, sir, it would appear that Mr. Morgan thought that he was the owner of those shares.”

Loans to Symphony Paint and Commodore Factors' Security

The history of Commodore Factors loan transactions with the Symphony Paint Company, both before and after its change of name, is illustrated on Table 57.¹ It will be seen that at December 31, 1962 the balance of the loan of \$350,000 in respect of which the first note was issued was \$308,000. A repayment of \$14,000 is shown, and it will be recalled that quarterly repayments in this denomination were required by the agreement of December 8, 1961. A further \$28,000, representing two instalments not paid when due, was re-loaned, together with unpaid interest of \$9,867, as part of a second loan in 1963, as illustrated under the three columns headed “Interest”. During 1962 five additional loans were advanced, two of which were subsequently repaid, one being on insurance policies in the amount of \$66,500, and the other a special inventory loan in the amount of \$59,000. The remainder consisted of \$57,000 to enable the company to repay additional factoring indebtedness to National Acceptance Corporation on which no payment was made to

⁴Exhibit 3238.

⁵Evidence Volume 66, pp. 9016-7.

¹Exhibit 3222.

Commodore Factors, another described as an inventory loan of \$41,389, and a third attributed to "operating notes" of \$159,800. The last two loans were subject to what was described as an "Inventory and Accounts Receivable Security Agreement"² which provided that "the aggregate unpaid principal of all such loans outstanding at any one time shall not exceed seventy per cent (70%) of the cost or market value whichever is lower of all inventory owned by Borrower, plus eighty per cent (80%) of the unpaid face amount of Qualified Accounts Receivable, plus one hundred per cent (100%) of the balance in the special account hereafter referred to". The special account was Commodore Factors' transfer account into which all payments on account of the receivables of Symphony Paint were to be remitted. At June 30, 1965 these loans, with additional advances and with interest capitalized at December 31, 1964, stood at \$1,075,061. The rapid deterioration of the security provided for under this agreement is illustrated by the following figures which do not include balances in the transfer account, since these were "flat" at the end of each year.³

	<i>Principal outstanding at December 31</i>	<i>80% of Receivables December 31</i>	<i>70% of Inventory December 31</i>	<i>Total</i>
1962	<u>\$208,987</u>	\$ 27,550	\$209,010	<u>\$236,560</u>
1963	<u>\$561,457</u>	\$ 92,140	\$179,090	<u>\$271,230</u>
1964	<u>\$873,942</u>	\$113,520	\$188,160	<u>\$301,680</u>
1965	<u>\$1,075,061</u>	\$ 74,000	\$121,660	<u>\$195,660</u>

The situation was not materially different from that of most of the large borrowers from Commodore Sales Acceptance and Commodore Factors, in that Symphony Paint, which incurred plant operating losses in 1961 and each year following, up to and including 1965, and added to its deficit each year to the point where at December 31, 1965 it amounted to \$1,270,689, continued to receive Atlantic funds, although clearly insolvent at the time of its default on the original loan and persistently thereafter. At this date the company's total outstanding debt was \$1,541,917 according to the books of Commodore Factors, and \$1,492,624 according to its own.⁴ The position of Jacroy Canada, a company related to the Symphony Paint Company although not subsidiary, since Symphony Paint professed to hold at the time of the transfer of shares to the Canada Trust Company only 324 out of a total of 1,296 common shares issued,⁵ was less spectacularly unprofitable. Between and including the fiscal years 1959 and 1964 the only audited

³Exhibit 911.7.

⁴Exhibit 3226.

⁵Exhibit 3222.

⁶Exhibit 3231.

financial statements were produced for the years 1959, 1960 and 1964. At the year-end in 1960 a surplus of \$78,428 was reported and by 1964 had become a deficit of \$239,083. At December 31, 1964 \$71,008 was shown as owing to the Symphony Paint Company, a debt apparently contracted in 1963 and assigned as a book debt of Symphony Paint to Commodore Factors. This amount was unpaid at August 11, 1965 when the Clarkson Company was appointed trustee in bankruptcy of Jacroy Canada on a petition filed by Commodore Sales Acceptance which claimed \$7,650 of debt. No amount appears as owing to Commodore Sales Acceptance in the history of its accounts receivable at June 17, 1965,⁶ and the origin of this claim is unknown. The amount owing to Symphony Paint was written off by that company on December 31, 1965, but recovery of some of this for Commodore Factors, as assignee of the book debts of Symphony Paint, is a possibility. Aurora Leasing Corporation has recovered some \$3,500 on a lease of equipment to Jacroy Canada shown at July 30, 1965 as owing in the amount of \$7,425 and the trustee believes that an additional \$1,000 may be paid.

The Trio and Jacroy Canada Limited

The most substantial claim against Jacroy Canada is attributable to the liability shown as "shareholders loans", amounting to \$116,445 at December 31, 1963. On September 4, 1963 the company received a cheque for \$100,000 drawn by Harry Wagman on the Trio account at the Guaranty Trust Company of Canada. The cheque¹ was dated July 11, 1963, as was the borrower's note,² and why the former was not presented until September 4 is a mystery. On July 25 in the following year Solomon wrote to Koryta at Bedford, Ohio, enclosing two promissory notes of Jacroy Canada for \$50,000 each in Canadian funds payable on demand, one to the order of C. Powell Morgan and the other to that of Harry Wagman, "as instructed by you",³ but the original note was retained. On the bankruptcy of Jacroy Canada, Wagman filed a claim as an unsecured creditor on behalf of himself, William L. Walton and C. Powell Morgan which was disallowed by the trustee. He thereupon applied for the trial of an issue in the Supreme Court of Ontario in Bankruptcy. This was directed on February 21, 1967 and Wagman was examined on behalf of the trustee on December 5 of that year. In the course of his evidence he acknowledged that a claim made on behalf of the Trio was based on their equal participation in the proceeds of the Guaranty Trust account and that he made the advance to Jacroy Canada on the instructions of C. P. Morgan, but could not recall why it was

⁶Exhibit 578.

¹Exhibit 1855.1.

²Exhibit 1704.1.

³Exhibit 1006.

done. He said further that he had not, to his knowledge, acquired or intended to acquire any shares of Jacroy Canada and that he was not aware of any intention of Morgan to do so. The patent untruthfulness of this disclaimer, given under oath, was characteristic of much of Wagman's evidence given on other examinations and before the Commission.⁴

Wagman's advance was applied against a loan from the Toronto-Dominion Bank which was made in February 1960 in the amount of \$125,000 on the security of Jacroy Canada's accounts receivable and inventory. The Commission has been advised by the assistant manager of the Yonge and Gerrard Streets branch that, at some time prior to October 1962, C. P. Morgan guaranteed repayment of \$50,000 of this amount and that in that month he advised the bank that he was the principal shareholder of M. L. B. Investments, Jacroy Canada and a company called Commercial Chemicals Limited which appears to have been related to the others. The repayment of \$100,000 on September 4, 1963 left some \$15,000 outstanding and did not have the effect of releasing Meckler's 109 and Lazar's 48 preference shares of Jacroy Canada which are in safekeeping, having been subsequently pledged as security for an additional loan of \$22,000 made to them in January 1965 of which \$18,000 was still owing in October 1968. Wagman's loan, out of the secret profits of the Trio, of such a substantial sum to a small company, the profitability of which in 1963 was in considerable doubt, to reduce its indebtedness to the bank, shows the importance to them of their acquisition of control of its stock. Their plans for its future have never been revealed.

Of the large sums of almost \$1,500,000 owed by the Symphony Paint Company to Commodore Factors only \$17,855 had been recovered by September 1968 and the attempts of the receiver and manager to place the company in bankruptcy in Ohio had, up to that point, been frustrated by legal action taken on behalf of some minority shareholders in Cleveland. If this is resolved a further \$75,000 may also be recovered. Recovery from Jacroy Canada of the sums advanced to it by Symphony Paint will also be part of this settlement. Since Harry Wagman is bankrupt and spectacular claims for current and pending liabilities amounting to \$69,000,000 have been made against his estate, the settlement of his \$100,000 claim against Jacroy Canada may not depend upon the trial of the issue directed in February 1967 which has not yet occurred. Amidst all the uncertainties surrounding this particular chapter of the lending of Atlantic funds is the fact that it provides clear evidence of the activities of C. P. Morgan and Harry Wagman on their own behalf, and apparently on behalf of W. L. Walton as well, at the expense of Atlantic Acceptance Corporation, with less than the usual amount of concealment.

⁴Commission file—Jacroy Canada Limited: Examination of Harry Wagman on Trial of Issue, December 5, 1967.

Pro Musica Limited

Pro Musica Limited was incorporated as a private company in the Province of Ontario on October 3, 1956 to carry on business as an importer, wholesaler, and retailer of radio and musical equipment. Of its 4,000 shares authorized without par value 301 shares each were held by Horst Paul Haddrath and Wilfrid Schneider and one by the company's solicitor, C. S. Frost, Jr., and the available evidence indicates that these shares were issued at a price of \$10 each.¹ Schneider ceased to be a director and shareholder on January 15, 1960, transferring 100 shares to Haddrath, 200 to one Stolting and one share to a chartered accountant named Rolf Kenton who became a director. On March 29, 1961, 931 additional shares were issued to Haddrath from the treasury and 466 shares to Stolting who thereupon transferred 126 to Haddrath. Stolting was never a director, and on February 28, 1962 ceased to be a shareholder, transferring his shares to Haddrath who, as a result, held 1,998. Since the issue of supplementary letters patent on March 31, 1960 the authorized capital of the company had become 4,000 common shares without par value and 2,000 preference shares with a par value of \$100 each, of which 295 were issued to Haddrath and 75 to his wife, Roswitha on May 2, 1960. According to the annual returns filed under the provisions of the Corporations Information Act of Ontario,² Frost resigned as a director on June 1, 1961, and only Haddrath and Kenton remained on the board until they were joined by L. Murray Eades on June 14, 1962. Eades, as has been seen, was frequently employed by W. L. Walton and this appointment foreshadowed a change of control.

Pro Musica imported radios and high fidelity and stereophonic gramophone units, mostly from the Loewe Opta concern in West Germany, and used the trade name of "Loewe Opta Pearl Sound". In 1959 it had acquired for \$61,279 a building of the warehouse type at 152 Pearl Street in Toronto which, later on, was also used to house the inventory of the Little Scot group of discount stores. Horst and Roswitha Haddrath operated three retail stores as outlets for the Pro Musica inventory, located in Toronto, Ottawa and Vancouver. By the spring of 1960 Pro Musica was in difficulty, with a large inventory of Loewe Opta equipment which was, for technical reasons, not attractive to Canadian purchasers and on which substantial sums were owed to the German exporters; it was moreover unable to extend its line of credit at the bank.

Loans and Security of Commodore Sales Acceptance

According to the evidence of A. G. Woolfrey, Haddrath approached C. P. Morgan personally, early in 1960, with a proposal to finance the sale of this inventory much of which was still in bond in

¹Exhibits 311-2.

²Exhibit 431.

public warehouses with duty owing.¹ At that point inventory was carried on the books of Pro Musica at \$250,000 and Morgan undertook to have Commodore Sales Acceptance lend against this security and that of its accounts receivable. The first advances were made on June 1, 1960, consisting of \$2,328.59 at 7% secured by accounts receivable and \$14,000 at 15% per annum secured by inventory on hand and represented by warehouse receipts. On June 29 the first advance of \$12,000 was made through a "notes receivable operating account". A fourth account for Pro Musica was opened on November 15, 1960 for loans on the security of warehouse receipts bearing interest at 15% per annum; the first advance under this head amounted to \$39,204.29.² Evidence as to these and all the loans made by Commodore Sales Acceptance to Pro Musica up until June 1965, and indeed all the evidence arising from the company records and books of account of both Pro Musica and Pearlsound Distributors, was given to the Commission by Mr. R. W. Scott, C.A. of Clarkson, Gordon & Co. on October 19, 1966³ and his summary of the loans and the assets securing them may conveniently be given here:⁴

PRO MUSICA LIMITED

Summary of Loans from Commodore Sales
Acceptance Limited and Security Therefor at
September 30, 1961-1964 and June 30, 1965

	<i>September 30,</i>				<i>June 30,</i>
	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
LOAN BALANCES					
Inventory.....	\$448,152	\$560,456	\$572,971	\$273,511	\$191,531
Note.....	105,000	170,975	136,836	413,438	612,135
Debenture (1).....			447,299	426,299	397,299
Accounts receivable.....		142,721			
Interest payable.....		88,285			
Total.....	<u>553,152</u>	<u>962,437</u>	<u>1,157,106</u>	<u>1,113,248</u>	<u>1,200,965</u>
SECURITY—at Book Value					
Inventory (2).....	473,538	668,732	614,648	296,003	219,947
Trade accounts receivable...	239,316	60,280	4,825	2,438	3,764
Fixed assets (3).....	27,968	53,050	61,773	58,143	56,664
Total.....	<u>740,822</u>	<u>782,062</u>	<u>681,246</u>	<u>356,584</u>	<u>280,375</u>
Apparent deficiency (excess) of security.....	<u>\$(187,670)</u>	<u>\$180,375</u>	<u>\$475,860</u>	<u>\$756,664</u>	<u>\$920,590</u>

NOTES: (1) Consolidation of accounts receivable, note and interest payable.

(2) Net of amount owing for duty and taxes on bonded stock.

(3) Net of amount owing on mortgage.

These figures show clearly that, as the loans increased from year to year, the aggregate value of the security diminished and more must be said of this phenomenon in due course.

¹Evidence Volume 102.

²Exhibit 953.

³Evidence Volume 72.

⁴Exhibit 3375.

**Pearlsound Distributors Limited: Purchase and Sale by
N. G. K. Investments**

Pearlsound Distributors Limited was incorporated as a private company on August 23, 1961 and its connection with the activities of Pro Musica is illustrated by the fact that a document dated August 18, expressing the consent of that company to the use of the name "Pearlsound", was forwarded to the Provincial Secretary's Department.¹ The provisional directors were Carl M. Solomon, David M. Samuel, Elizabeth R. Crisp and B. L. McFadden, assistant treasurer of Atlantic Acceptance Corporation, but were at once replaced by C. P. Morgan, Carman G. King, Reginald A. Palmer, Wilfrid P. Gregory and Sidney Fromer. These were, of course, the directors of N.G.K. Investments Limited which its principals, some four months earlier, had planned to have invest \$50,000 in acquiring shares of Pro Musica. The decision to do so was, according to its minutes, taken at a meeting of the board of N.G.K. Investments on April 20, 1961,² but the plan, for whatever reason, was not proceeded with. Instead, on the very day of the incorporation of Pearlsound Distributors, the board of N.G.K. Investments resolved to subscribe for 50,000 shares of the capital stock of that company at a price of \$1 per share. The odd, but perhaps not unexpected feature of this transaction was that payment for these shares was made in June of 1961 before the incorporation of the company, and just as odd was the manner of payment which was described in the evidence given by Mr. K. L. Ingo, C.A., of Clarkson, Gordon & Co., on the subject of N.G.K. Investments.³ On June 2, 1961 that company issued a cheque for \$10,000⁴ payable to Solomon & Samuel who, on the same day, drew a cheque on their trust account payable to Pro Musica in the same amount.⁵ Noted on the cheque were the words, "In settlement of N.G.K. Investments Limited purchase from Pro Musica Limited—Pearlstone". The last word, after considering all the evidence, can be nothing other than an erroneous rendering of "Pearlsound", and since Pearlsound Distributors set up in its accounts a deferred development cost of \$10,000 as an asset, it evidently treated this payment as consideration for the use of the "Pearlsound" name and connection. Then, on June 16, N.G.K. Investments issued another cheque directly to Pro Musica for \$40,000 which Pearlsound recorded as a loan to that company, eventually set off against a liability for management fees as will be seen; but the deferred development cost was carried as an asset in the amount of \$10,000 in every

¹Exhibit 428.

²Exhibit 282.

³Evidence Volume 11.

⁴Exhibit 1247.

⁵Exhibit 1249.

financial statement of Pearlsound until it became a wholly owned subsidiary of Commodore Business Machines in April 1965, and was still shown on the balance sheet as at June 30 of that year.⁶

There is no direct evidence of C. P. Morgan's plans for Pearlsound Distributors, but it may be concluded, since the consent of Pro Musica was obtained for the use of the name "Pearlsound" and since at September 30, 1961 Pro Musica was shown to be in a deficit position of \$121,-996 as to its shareholders' equity after incurring a loss of \$155,084 for the year, that the original plan to invest in that company had, quite early in 1961, been found demonstrably unprofitable; Pearlsound Distributors was therefore selected to conduct a salvage operation. Woolfrey described it as a manufacturer of Canadian radio products, but the better informed evidence of Hans Heinrich Vogt,⁷ production manager of Pro Musica since 1959, indicates that, because Pro Musica was becoming discredited in the trade, an early attempt was made to have Pearlsound adapt the Loewe Opta equipment and sell it as the product of the new company. Morgan, as usual, was reluctant to admit that his assessment of a borrower had been wrong, and Woolfrey said that he had worked hard for two years to convince Morgan that Haddrath should be removed from the picture. Indeed it took a full year after the incorporation of Pearlsound for this to be arranged, and the manner in which it was done, and the solution provided for the difficulties of Pro Musica, must be considered.

Pro Musica's premises at 152 Pearl Street were encumbered by a first mortgage given by it to the vendors of the property which amounted at the beginning of 1961 to security for \$24,000 and bore interest at 7½ % per annum. At that time, and in addition to several promissory notes as evidence of advances to Pro Musica, Commodore Sales Acceptance had taken a second mortgage for \$36,000 and also acquired for \$24,500 a first floating charge debenture given to the Bank of Nova Scotia by Pro Musica in 1959 to secure a loan of \$65,000. Under the provisions of this instrument, Vogt, who had resigned his position with Pro Musica in July 1962 but who had retained the confidence of Woolfrey, was on August 10 appointed receiver of all the company's undertaking, property and assets, and notice of this appointment and of its default under the debenture was given to Pro Musica in a letter from Woolfrey of that date.⁸ Vogt testified that on reviewing the operations of Pro Musica he decided that there had been gross inefficiency in its management by Haddrath, and by an agreement concluded on September 12, 1962⁹ the Haddraths surrendered their interest in Pro Musica

⁶Exhibit 3394.

⁷Evidence Volume 72.

⁸Exhibit 3393.

⁹Exhibit 1029.1.

OTHER MAJOR LOANS

in consideration of Commodore Sales Acceptance forbearing to proceed against them personally as guarantors of the company's indebtedness to it. In addition to their liability on these guarantees, the Haddraths were indebted to Commodore Sales Acceptance in the amount of \$87,310.95, a sum secured by three chattel mortgages on the stock and appointments of the Toronto, Ottawa and Vancouver retail stores, and in this case also Commodore Sales Acceptance forebore to realize on its security, allowing them to continue in business in exchange for an acknowledgment of the debt, a third mortgage on their Toronto residence, and a chattel mortgage on their automobile specifically securing an amount of \$8,000 to which loans made to them by Pro Musica, amounting to over \$63,000, were by agreement reduced. The main concession, however, made by the Haddraths by the terms of this agreement between them and Commodore Sales Acceptance, and to which Pro Musica and Pearlsound and Elizabeth R. Crisp as trustee were also parties, was their undertaking to hand over the 2,000 common shares of Pro Musica to the last-named who was a stenographer in the office of Solomon, Singer & Rosen. A transfer was subsequently completed on October 28 by which 1,996 shares went to this trustee and two (which were in fact all the remainder) to members of the new board, which on September 28 was reconstituted with Hans Vogt as president of the company, Frederick Draper as secretary-treasurer and Miss Crisp, Carl M. Solomon and Irwin Singer as the other directors.¹⁰

The agreement was executed for Pearlsound Distributors by Manfred Kapp who had become secretary-treasurer of that company on July 27, 1962 as a result of the sale of its shares by N.G.K. Investments to Evermac Office Equipment Company. At the same time Jack Tramiel became president of Pearlsound and Vogt became manager. When Vogt gave his evidence to the Commission, on October 19, 1966, he described himself as general manager of Commodore Business Machines (Canada) Limited and there is no doubt, from the presence on the new board of Pro Musica of Draper, who was Commodore Business Machines' book-keeper, and from a letter of Irwin Singer reporting on the transfer of the Haddrath shares, addressed to Elizabeth R. Crisp in trust in care of Manfred Kapp, that Pro Musica had at this point effectively joined Pearlsound as a member of the Tramiel and Kapp group of companies. Nevertheless the common shares held by Elizabeth Crisp in trust and the preference shares belonging to Mr. and Mrs. Haddrath, which were assigned in blank and delivered to Solomon, Singer & Rosen, remained in their custody until long after the assumption of control of the affairs

¹⁰Exhibit 3370.

of Pro Musica by the Clarkson Company in July 1965. Singer wrote another letter directly to Kapp on December 6 for the purpose of conveying "other details of services rendered by us in connection with the said acquisition which are of a confidential nature and should not be recorded with the general report."¹¹ He referred to the shares in the custody of his firm, concluding, "We await your instructions as to the identity of the ultimate beneficial owner of both the common and preference shares of the company, so that the blanks in the minutes of the company may be filled in". The reason for these curious arrangements may become apparent as this account proceeds, but a final conclusion may be anticipated by saying that Pro Musica was to be sacrificed for the benefit of Pearlsound and Commodore Sales Acceptance was to pay the bill.

For the shares of Pearlsound, N.G.K. Investments received 17,500 shares of Commodore Business Machines purchased by Evermac at \$3 per share from Don Mills, which, as will be recalled, was a partnership of Morgan, Tramiel and Kapp at a time when the free shares of that company were trading at prices between \$1.70 and \$2.25 per share.¹² Pearlsound played its part in the acquisition of Humber Typewriters & Business Equipment Limited on July 30, 1962, only three days after its own shares had been bought by Evermac, and in due course Humber Typewriters was sold by Pearlsound to Evermac and resold to Commodore Business Machines in a series of transactions, more fully described in Chapter VIII, which put a profit in the hands of Tramiel and Kapp at the expense of the shareholders of Commodore Business Machines of which they were officers and directors. It was not until April 9, 1965 that Evermac sold its 50,000 shares of Pearlsound to Commodore Business Machines for 7,500 shares of that company, issued from the treasury and at that time valued at \$70,000, and Pearlsound has since continued to be an apparently profitable subsidiary of Commodore Business Machines, assembling and distributing imported radio and gramophone equipment under its own name.

Financial Record of Pro Musica

The inventory of Pro Musica at September 30, 1962, carried at \$950,748 and consisting largely of Loewe Opta equipment imported in that year, was thereafter to be liquidated through the agencies and dealerships of Pearlsound across the country and Pro Musica ceased to carry on its normal business. For a time Vogt reported to Woolfrey, but

¹¹Exhibit 1029.4.

¹²Chapter VIII.

OTHER MAJOR LOANS

early in 1963, according to his own account, he began to take his instructions from Tramiel and Kapp and the duty-paid inventory of Pro Musica was in due course transferred from the Pearl Street premises to those of Commodore Business Machines in Scarborough. The condensed comparative balance sheets and statements of profit and loss, prepared by Mr. Scott from the unaudited financial statements produced by Walton, Wagman & Co. on which no opinion was expressed, and an internal hand-written statement for June 30, 1965 prepared directly from the company's books, are as follows:¹

PRO MUSICA LIMITED CONDENSED BALANCE SHEETS

	<i>September 30,</i>				<i>June 30,</i>
	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
ASSETS					
Current:					
Accounts receivable.....	\$239,316	\$ 60,280	\$ 4,825	\$ 2,438	\$ 3,764
Inventories.....	473,538	950,748	827,322	381,438	270,373
Other	(1) 98,560	7,983	1,226	925	56
	<u>811,414</u>	<u>1,019,011</u>	<u>833,373</u>	<u>384,801</u>	<u>274,193</u>
Fixed Assets—cost.....	77,119	86,499	77,523	71,893	67,164
	<u>\$888,533</u>	<u>\$1,105,510</u>	<u>\$910,896</u>	<u>\$456,694</u>	<u>\$341,357</u>
LIABILITIES					
Current:					
Bank.....	\$ 17,379	\$ 3,450			
Accounts payable.....	327,155	553,869	\$278,388	\$167,251	\$ 99,184
Commodore Sales					
Acceptance Ltd.	(2) 553,153	962,438	709,807	687,949	803,566
Pearlsound Distributors					
Ltd.....	26,165	32,780			
	<u>923,852</u>	<u>1,552,537</u>	<u>988,195</u>	<u>855,200</u>	<u>902,750</u>
Debentures payable—					
Commodore Sales					
Acceptance Limited....			447,299	426,299	397,299
Mortgage payable....	49,750	18,750	15,750	12,750	10,500
Shareholders—					
Share capital.....	36,927	36,927	36,927	36,927	36,927
(Deficit).....	(121,996)	(502,704)	(577,275)	(874,482)	(1,006,119)
	<u>(85,069)</u>	<u>(465,777)</u>	<u>(540,348)</u>	<u>(837,555)</u>	<u>(969,192)</u>
	<u>\$888,533</u>	<u>\$1,105,510</u>	<u>\$910,896</u>	<u>\$456,694</u>	<u>\$341,357</u>

(1) Including advances to shareholders \$83,025.

(2) Includes advance of \$24,500 to repay previous loan of the Bank of Nova Scotia to Pro Musica Limited. In exchange for repayment of this loan Commodore Sales obtained a power of attorney with respect to the bank's debenture security.

¹Exhibits 3382-3.

CONDENSED STATEMENTS OF PROFIT AND LOSS

	Year ended September 30,				9 months ended June 30, 1965
	1961	1962	1963	1964	
Income:					
Sales.....	\$792,727	\$869,109	\$542,623	\$466,341	\$151,848
Cost of sales.....	638,537	857,256	438,300	595,165	162,830
Gross profit (loss).....	154,190	11,853	104,323	(128,824)	(10,982)
% of sales.....	20%	1%	19%	(28%)	(8%)
Expenses:					
Interest charges.....	84,485	103,140	85,319	66,690	74,516
Wages.....	80,224	124,030	66,230	57,203	31,813
Other.....	144,565	139,492(1)	27,345	44,490	14,326
	309,274	366,662	178,894	168,383	120,655
Net loss.....	<u>\$(155,084)</u>	<u>\$(354,809)</u>	<u>\$(74,571)</u>	<u>\$(297,207)</u>	<u>\$(131,637)</u>

STATEMENT OF DEFICIT

Balance beginning of year..	\$ (33,088)(2)	147,895	\$502,704	\$577,275	\$874,482
Loss for year.....	155,084	354,809	74,571	297,207	131,637
Balance end of year.....	<u>\$121,996</u>	<u>\$502,704</u>	<u>\$577,275</u>	<u>\$874,482</u>	<u>\$1,006,119</u>

- (1) After deduction of an administration fee of \$37,776 taken into income out of a total charge to Pearlsound Distributors of \$44,276.
- (2) Opening balance 1962 exceeds closing balance 1961 by \$25,899; reason for difference not known.

It will be seen at a glance that the accounts receivable dwindled year by year, as did the inventories from their peak at September 30, 1962, but that the indebtedness to Commodore Sales Acceptance, for the loans of which these assets were security, increased to a total at June 30, 1965 of \$1,200,965. From September 30, 1963 through to June 30, 1965 the current liability to Commodore Sales Acceptance must be supplemented by loans made pursuant to a floating charge debenture given by Pro Musica to Commodore Sales Acceptance in the amount of \$450,000, not bearing interest and dated February 1, 1963.² In this connection reference must again be made to the summary of loans from and security held by Commodore Sales Acceptance.³ While Pro Musica ceased to add to its inventory to any appreciable extent after 1962 it still had accounts and customs and brokerage accounts to be met, so that the portion of its inventory still in bond could be released and made available for sale to Pearlsound on terms which did not, as will be seen, defray these costs; above all its payments of interest to Commodore Sales Acceptance under the circumstances could only be made through receipt of additional loans.

²Exhibit 908.

³p. 937.

Pearlsound's Profits and Pro Musica's Losses on Sale of Inventory

It will be noted from the condensed statements of profit and loss that a gross profit at September 30, 1963 of \$104,323, producing a net loss of \$74,571, was transformed at the end of the next fiscal year into a gross loss of \$128,824 and a net loss of \$297,206. Mr. Scott's examination of Pro Musica's accounting records indicated quite clearly that a large portion of the inventory sold to Pearlsound was transferred at a price substantially less than Pro Musica's cost. Mr. Scott examined transactions involving eight different units of the Pro Musica inventory, selected at random, and compared their inventoried cost, the price paid in respect of each unit by Pearlsound to Pro Musica and Pearlsound's price to its retailers, arriving at the gross profit or loss of Pro Musica and Pearlsound and corresponding percentages of the selling prices. From this study of the invoices and inventories¹ it is clear that, whereas on six out of the eight groups Pro Musica suffered a loss ranging from 15% to 57% of its selling price to Pearlsound, Pearlsound made a profit on all units resold ranging from 6% to 63%. Generally speaking, Pro Musica was forced to accept from Pearlsound a price below its inventory cost and Pearlsound resold at a figure which secured to itself a substantial profit. Even in the two cases where Pro Musica was permitted a profit over inventory cost, in one case of 31% and in the other of 33%, Pearlsound received a profit of 44% and 22% respectively. The effect of this method of disposing of the inventory of Pro Musica for the fiscal year ended September 30, 1964 was further analysed by taking the estimated minimum sales volume of five Pro Musica products, all disposed of to Pearlsound, showing the gross loss of Pro Musica, the gross profit of Pearlsound and the ratio of the gross loss to Pro Musica on these transactions to that of its total sales. The sales of these products to Pearlsound inflicted a gross loss of \$39,969 on Pro Musica, accounting for 31% of its total gross loss of \$128,824, and gave Pearlsound the opportunity to realize a gross profit of \$18,803 on the resale of the items in question. The results of Mr. Scott's analysis can be observed on Tables 58 and 59² and it is difficult to escape the conclusion that even in this year Pro Musica could have disposed of its own inventory at least at cost, and possibly at a profit, if Pearlsound had not been interposed between it and the retail purchaser. In the meantime the position of Commodore Sales Acceptance, which continued to make loans to Pro Musica in the teeth of its operating losses and chronic insolvency, may be illustrated by the following figures,³ not including loans against inventory which, as

¹Exhibits 3384-7.

²Exhibits 3388-9.

³Exhibit 3377.

will be seen from reference back to page 937, were largely, although not absolutely, secured by the assignment of trust receipts:

PRO MUSICA LIMITED

Increase in Loans and Losses on Operations
September 30, 1961 to June 30, 1965

	<i>Loan balances (excluding inventory loans)</i>	<i>Increase in period</i>	<i>Operating losses</i>
September 30, 1961	\$ 105,000		
September 30, 1962	401,981	\$296,981	\$354,909
September 30, 1963	584,135	182,154	74,571
September 30, 1964	843,737	259,602	297,206
June 30, 1965	1,009,434	165,697	131,637
			<u>858,323</u>
Reduction in mortgage payable in 1961-1965			39,250
Total		<u>\$904,434</u>	<u>\$897,573</u>

Financial Statements of Pearlsound

The financial picture presented by the operations of Pearlsound Distributors was under these circumstances understandably different from that of Pro Musica. Its fiscal year ended on June 30, as did that of Commodore Business Machines, and the loans made to it by Commodore Sales Acceptance, as recorded at the year-end in 1962, 1963 and 1964 and at March 31, 1965, together with that of the security provided consisting of assignments of accounts receivable and inventory, were summarized by Mr. Scott as follows:¹

	<i>June 30</i>		<i>March 31</i>	
	<i>1962</i>	<i>1963</i>	<i>1964</i>	<i>1965</i>
Loans				
Inventory and accounts receivable loans	<u>\$38,983</u>	<u>\$ 86,004</u>	<u>\$110,362</u>	<u>\$116,909</u>
Security				
Accounts receivable ..	24,469	73,154	120,888	128,999
Inventory	12,190		27,832	63,554
	<u>36,659</u>	<u>73,154</u>	<u>148,720</u>	<u>192,553</u>
Apparent excess (deficiency) of available security	<u>\$(2,324)</u>	<u>\$(12,850)</u>	<u>\$ 38,358</u>	<u>\$ 75,644</u>

¹Exhibit 3378

OTHER MAJOR LOANS

The condensed comparative balance sheets for the period² were prepared to reflect the position at the same dates from financial statements submitted by Walton, Wagman & Co. and the successor firm Wagman, Fruitman & Lando, audited and with unqualified opinions for the years 1962, 1963 and 1964,³ and from an unaudited statement for the nine-month period ended March 31, 1965⁴ found annexed to the agreement dated April 7 by which Evermac sold the 50,000 shares of Pearlsound to Commodore Business Machines for \$70,000 in which, incidentally, the statement for the nine-month period is described as "audited".

PEARLSOUND DISTRIBUTORS LIMITED CONDENSED BALANCE SHEETS

Assets	1962	June 30 1963	1964	March 31 1965
Current:				
Cash and Banks	\$ 2,602	\$ 818	\$ 934	\$ 100
Accounts receivable	24,469	73,154	120,888	128,999
Notes receivable		55,162	28,684	8,826
Inventory	12,190		27,832	63,554
Prepaid expenses		5,386	3,150	3,900
	<u>\$ 39,261</u>	<u>\$134,520</u>	<u>\$181,488</u>	<u>\$205,379</u>
Other:				
Due from Pro Musica Ltd.	45,787			
Deferred franchise cost	12,000	12,000		
Deferred development cost	10,000	10,000	10,000	10,000
Incorporation expense	585	585	585	585
	<u>\$ 68,372</u>	<u>\$ 22,585</u>	<u>\$ 10,585</u>	<u>\$ 10,585</u>
	<u>\$107,633</u>	<u>\$157,105</u>	<u>\$192,073</u>	<u>\$215,964</u>
Liabilities				
Current:				
Bank overdraft				\$ 1,875
Accounts payable	\$ 2,023	\$ 1,569	\$ 38,120	\$ 44,878
Loans and notes payable	4,400	55,162	28,684	8,826
Due to finance company	38,983	86,004	110,362	116,909
Wages payable			30,000	30,000
	<u>\$ 45,406</u>	<u>\$142,735</u>	<u>\$207,166</u>	<u>\$202,488</u>
Due re franchise costs	12,000	12,000		
	<u>\$ 57,406</u>	<u>\$154,735</u>	<u>\$207,166</u>	<u>\$202,488</u>
Shareholder's Equity				
Share capital	\$ 50,000	\$ 50,000	\$ 50,000	\$ 50,000
Surplus (deficit)	227	(47,630)	(65,093)	(36,524)
	<u>\$ 50,227</u>	<u>\$ 2,370</u>	<u>(\$ 15,093)</u>	<u>\$ 13,476</u>
	<u>\$107,633</u>	<u>\$157,105</u>	<u>\$192,073</u>	<u>\$215,964</u>

²Exhibit 3390.

³Exhibits 335-7.

⁴Exhibit 887.1.

The corresponding condensed statements of profit and loss prepared on the same basis were also introduced into evidence by Mr. Scott:⁵

PEARLSOUND DISTRIBUTORS LIMITED
CONDENSED STATEMENTS OF PROFIT AND LOSS

	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>March 31</u> <u>9 Mos.</u> <u>1965</u>
Income:				
Sales	\$102,070	\$554,622	\$558,402	\$357,129
Cost of sales	<u>82,771</u>	<u>497,954</u>	<u>459,950</u>	<u>249,382</u>
Gross Profit	\$ 19,299	\$ 56,668	\$ 98,452	\$107,747
% of Sales	19%	10%	18%	30%
Expenses				
Interest and bank charges	\$ 1,430	\$ 8,675	\$ 15,969	\$ 14,193
Management fees	6,500	45,776	30,182	
Bad debts	2,048	15,743	10,766	4,335
Commissions	3,813	19,642	22,781	14,334
Other Expenses	<u>5,281</u>	<u>14,689</u>	<u>36,217</u>	<u>46,316</u>
	\$ 19,072	\$104,525	\$115,915	\$ 79,178
Net Profit (Loss)	<u>\$227</u>	<u>\$(47,857)</u>	<u>\$(17,463)</u>	<u>\$ 28,569</u>

STATEMENT OF DEFICIT

Balance beginning of year		\$227	\$(47,630)	\$(65,093)
Profit (Loss) for the year	\$227	<u>(47,857)</u>	<u>(17,463)</u>	<u>28,569</u>
Surplus (Deficit) end of year ..	<u>\$227</u>	<u>\$(47,630)</u>	<u>\$(65,093)</u>	<u>\$(36,524)</u>

It will be seen that the position at March 31, 1965 for the first time showed a profit in the amount of \$28,569, although there was still a deficit of \$36,524 as a result of the previous years' operations, and that the effect of the operations for the nine-month period ended March 31, 1965 was to transform the shareholders' equity from a deficit position of \$15,093 to a surplus of \$13,476. This was a happy occurrence on the eve of the purchase of Pearlsound by Commodore Business Machines which had to be approved by the latter's board of directors. Subsequent to the evidence given by Mr. Scott, Frederick Draper produced a balance sheet for the year ended June 30, 1965,⁶ prepared after audit by Rose & Harrison, auditors for Commodore Business Machines, who gave an unqualified opinion. From this statement it appears that in the course of the next three months the profit shown at March 31, 1965 was reduced by \$10,300 and that the shareholders' equity was shown at \$3,201.63. The increase in inventory from \$27,832, shown at June 30, 1964, to \$63,554 at March 31, 1965, combined with a marked proportionate decrease in the cost of sales in the nine-month period, as compared with that of the previous fiscal year, are substantially responsible for the improvement and were undoubtedly obtained

⁵Exhibit 3392.

⁶Exhibit 3394.

OTHER MAJOR LOANS

at the cost of Pro Musica, the inventory of which was by the end of the period physically under the control of Commodore Business Machines. The reduction of profit reflected at June 30, 1965 was principally due to an increased provision for and write-off of bad debts in the net amount of \$10,000, and a rental and management charge by Commodore Business Machines of \$9,000, which, with miscellaneous expenses, produced a total change in indirect costs of \$21,400.

The evidence of Hans Vogt and Frederick Draper⁷ makes it clear that after September 30, 1962 Pro Musica and Pearlsound were operated as one enterprise, under the direction of Messrs. Tramiel and Kapp and with the knowledge of C. P. Morgan and A. G. Woolfrey who supplied the funds. Counsel put to Vogt that, left to itself, Pro Musica would have fared better in the disposal of its inventory, but Vogt did not agree and said that Pro Musica's position in the trade was so precarious, and its name discredited as belonging to an insolvent company, that the expedient adopted of disposing of the inventory through Pearlsound was the only feasible solution. This, indeed, is the only argument to justify the arrangement, but it does not apply to the situation of Commodore Sales Acceptance which lent money to both companies against assignments of accounts receivable and the security of their inventories, and was in a unique position to understand and to sponsor the disastrous accumulation of debt owing by Pro Musica and the unjustifiable advantages conferred upon Pearlsound. Commenting on the disposal of items of Pro Musica's inventory, the author of the review of these loans made for the Clarkson Company Limited⁸ put the matter succinctly:

"For example, when Pearlsound sold a Pro Musica radio for say \$100 they would purchase this from Pro Musica for \$60 to assure themselves of a 66⅔ % markup.

To Pro Musica, the \$60 they received was much below their costs and of course represented a serious loss of up to 35%. As Pro Musica had borrowed the full cost from Commodore Sales Acceptance under receipts, they then assigned to Commodore Sales the invoice charging sales to Pearlsound. As this invoice was up to 35% below the amount borrowed from Commodore Sales, the loss or difference was set up as an additional loan from Commodore Sales to Pro Musica under the heading 'Notes Payable and Receivable'. This intriguing technique resulted in the paradoxical situation in the previous paragraph whereby the lender, Commodore Sales, increases their loans while the security diminishes, in this instance most unusual as the lender was not only aware of the situation but set up the accounting procedures to perpetuate it.

As for Pearlsound Distributors, they now had acquired for themselves a 66% markup on Pro Musica inventory by unilaterally establish-

⁷Evidence Volume 72.

⁸Exhibit 5124.

ing the latter's selling prices. Pearlsound Distributors then pledged their own sales invoices to Commodore Sales who advanced full value in return.

The end result of the above was substantial losses for Pro Musica and profits or breakeven for Pearlsound (after expenses) and both losses as well as profits coming out of Commodore Sales.

It is interesting to note that all the above was openly on the records of Commodore Sales Acceptance and available to their auditors who failed to comment in their notes that as Commodore Sales increased their advances, their security continuously diminished even below the unreasonable starting ratio."

Evidence of Wagman, Lando and Fruitman: The Allowance for Bad Debts

The negligence and, indeed, delinquency of Walton, Wagman & Co. and Wagman, Fruitman & Lando can scarcely be better illustrated than by their acquiescence in the extraordinary state of affairs described above and apparent to any auditor almost at a glance. They have particular significance in relation to the establishment of an allowance for doubtful accounts in the case of Commodore Sales Acceptance which provided all the money and was Pro Musica's most substantial creditor. When Harry Wagman was examined before the Commission, counsel, as might be expected, dealt fully with this subject and, generally speaking, Wagman attempted to shift the whole burden on to the shoulders of his junior partners, Martin Fruitman and Albert M. Lando. After putting to the witness the fact that in respect of accounts receivable of Commodore Sales Acceptance, amounting in the round to \$30,448,000, the total amount reserved was only \$678,000 approximately, or a little over 2% at December 30, 1964, Fruitman's working papers¹ were produced and the larger loans considered. The following exchange took place on the subject of the allowance in respect of loans to Pro Musica of approximately \$1,000,000:²

"Q. . . . Then can you tell me by looking at the working papers how much reserve the auditors set up against the debt of Pro Musica?

A. No I couldn't readily tell you here from going through.

Q. Is that not because it isn't set out in the working papers, the reserve is not broken down, is it?

A. Well I don't see it offhand.

Q. What knowledge did you have of the ability of Pro Musica Limited to pay its debts?

A. I don't recall what Pro Musica had in their company as the ability to repay or what they had, I couldn't say.

¹Exhibit 3592.

²Evidence Volume 83, pp. 11189-92.

OTHER MAJOR LOANS

Q. Perhaps it would assist you if I put it to you that there was a deficit in assets of \$837,000 as at the 30th of September, '64, and that your firm declined to give an unqualified opinion upon the statement. I now show you Exhibit 314, this being the same exhibit as I showed you a moment ago. That is correct, is it not?

A. Yes it is.

Q. So there is a total capital deficit of \$837,000 for the year the company lost \$297,206. Did you have any discussion with anybody to determine the ability of that company to pay its debts?

A. No, as I mentioned before I didn't discuss any specifics of any companies.

Q. In case you are overlooking this by reason of the number of companies involved, do you recall whether you had any discussion with Mr. Tramiel or Mr. Kapp relative to this indebtedness?

A. I don't think I had personally. I can't recall any personal discussions.

Q. I see. In default of some additional information which perhaps the other members of the firm may be able to help us with, would you agree that on its face it looks as though a very substantial reserve would be required for any indebtedness outstanding in respect of that company?

A. There could be some other reason for it, though.

Q. Well, Mr. Wagman, we could spend a very long time, I suppose, at this. Is your position simply that there is no point in me asking you questions relating to the adequacy of the allowance for losses, there is no point in me putting to you the particulars of the financial ability of the debtor companies because you did not direct your mind to this nor were you the person who established the allowance for losses so far as your auditing firm is concerned?

A. Not that I didn't put my mind to it. I am interested in everything that goes about but as I mentioned before I feel that the men on the job, Mr. Fruitman who is a very capable fellow and very conscientious and very concerned about the work he does and Mr. Lando in turn checking that I felt that I was quite reasonably safe in accepting the answer that we came to after the discussion that I had with these two men.

THE COMMISSIONER: Well then, can I relate that answer to the question that counsel put to you about the adequacy of the allowance for losses for the year 1964 in connection with the audit of Commodore Sales Acceptance? I think you were asked whether or not it was discussed with you and you said 'Yes, before the statement was typed', it would be discussed with you and can I take it that you were satisfied that that allowance was adequate?

A. I agreed with their decision on it.

Q. Isn't that the same thing?

A. Yes."

Lando and Fruitman were also examined on November 21, 1966, when Wagman concluded his evidence. Lando testified to attending a meeting with C. P. Morgan at which, he said, Wagman and Fruitman also were present, although this had been denied by Wagman as to his own presence an hour or two beforehand, to discuss the Commodore Sales Acceptance statement particularly in relation to the allowance for doubtful accounts which Morgan was trying to establish.³

"Q. Well then, you did, in fact, all meet to discuss the appropriate allowance with Mr. Morgan. Is that correct?

A. I recall such a meeting.

Q. And what did you do there?

A. We reviewed the accounts with him and various matters were brought to his attention that we noted during the course of the examination. Explanations were requested of general policy, also with respect to specific accounts. I think that would just about cover the discussions at that meeting.

Q. Yes. Can you recall any specific account which sticks in your mind more than any other so that we might choose that to be more detailed? Pro Musica was mentioned this morning.

A. Yes, I remember something about that particular file."

There followed some discussion about the nature and numbering of the exhibits put to the witness which may be omitted and the examination continued:⁴

"Q. You were saying that you had some recollection of this. What is your recollection of the discussion respecting the allowance for Pro Musica? Let me put it to you that the total loan outstanding from Pro Musica to Commodore Sales Acceptance was \$1,139,443. It is to be found in three or four different headings in the working papers. Yes, please go ahead.

A. We would have pointed out to Mr. Morgan at the time that there is—

THE COMMISSIONER: Would you mind telling me, Mr. Lando, is there any significance when you say 'we would have pointed out'?

A. I am sorry—well, 'we did', I am sorry. It is wrong, it is not right—we did point out to him the apparent deficiency between the amount of the loan and the inventory value on the balance sheet and the other fixed assets included.

³Evidence Volume 83, pp. 11217-8.

⁴Evidence Volume 83, pp. 11219-23.

OTHER MAJOR LOANS

MR. SHEPHERD: I think I am correct—you have the balance sheet in front of you—the book value of the net tangible assets is in the order of a deficiency of \$837,000 or something like that?

A. I don't know that it is 837—

Q. It is at the bottom of the balance sheet there, I believe.

A. Oh, yes, I am sorry—yes.

Q. Yes. That would be one of the figures to which you would refer?

A. Yes.

Q. Yes, and what occurs then?

A. We advised him of a deficiency and asked an explanation for it, as to what the prognosis was, the probability of collecting this account.

Q. Yes.

A. He in turn advised us that there was a \$500,000 guarantee on this account from Messrs. Tramiel and Kapp.

Q. Mr. Morgan told you that Messrs. Tramiel and Kapp had guaranteed the account to the extent of \$500,000?

A. That is correct.

Q. Yes?

A. And that he did expect there would be some loss and he would take it into account in determining his reserve.

Q. What evidence did he produce to support his assertion that there was a guarantee? I put it to you that, I believe, in fact there was not.

A. I confirmed this myself, with Mr. Tramiel and Mr. Kapp.

Q. Did you have some conversation with them?

A. Yes, it was mentioned although I don't recall having seen it in writing.

Q. Who spoke? Mr. Tramiel or Mr. Kapp or both of them?

A. Mr. Tramiel, I believe.

Q. What did he say?

A. He acknowledged that he and Mr. Kapp were guaranteeing the Pro Musica loss to the extent of \$500,000.

Q. Did you see any written document which would assist Commodore Sales Acceptance in the event that it had to rely on such guarantee?

A. I did not recall that I did, sir.

Q. Since that time, I take it that you have not seen any guarantee in fact?

A. No, sir.

Q. Did Mr. Tramiel tell you that he was guaranteeing it? Is that correct?

A. I don't recall his words, but he did acknowledge it, but mention was brought—pardon me—the matter was brought up in front of him and he acknowledged it.

Q. What I am trying to get at for sure, and I may be misunderstanding you, did you understand Mr. Tramiel simply to be saying that he was confident that \$500,000 would be forthcoming in due course or did you understand him to say that he personally was guaranteeing the payment of Pro Musica's debt to Commodore Acceptance to the extent of \$500,000?

A. I understood that Commodore Sales Acceptance would receive through his efforts or from him \$500,000 towards the loss incurred in the Pro Musica account.

Q. That he was personally liable to pay it?

A. Well, we didn't discuss it in terms of personal liability in the legal sense, just that he acknowledged that such a guarantee did exist, that he and Mr. Kapp were behind that guarantee.

Q. Personally?

A. Yes, I understood it to be personally.

Q. Then, did you form the impression that if default occurred on that loan, Commodore Sales Acceptance would be entitled to look to the personal assets of Mr. Tramiel and Mr. Kapp to the extent of \$500,000?

A. Yes, I did.

Q. As a result of that conversation then, what reserve, if any, did you find it necessary to set up against Pro Musica?

A. If you would excuse me, Mr. Shepherd, we didn't set up the reserves; we considered it as a factor, as we did everything else in determining the adequacy of the reserves as set by management, it being their function to do so. For how much, it is very very hard to define the exact policy amount."

Fruitman, who was responsible for the audit of Commodore Sales Acceptance itself, testified to the particular rôle played by Lando in reviewing the accounts of Pro Musica and also to his recollection of the extraordinary undertaking said to have been given by Tramiel on behalf of himself and Kapp.⁵

"MR. SHEPHERD: The one which was discussed earlier with Mr. Lando, Pro Musica?

A. In that account Mr. Lando had specific knowledge of it so the amount of work I would have done would have been less than some of the others.

Q. Mr. Lando was concerned with the audit of the company itself, I take it?

A. I believe so. I would have to see the working papers.

⁵Evidence Volume 83, pp. 11269C-9E.

OTHER MAJOR LOANS

Q. Were you present at the discussion about which Mr. Lando has testified when Mr. Morgan, as I recall his evidence, said something to the effect that there was a guarantee of half a million dollars extended by Messrs. Tramiel and Kapp affecting the liability of Pro Musica to pay Commodore Sales Acceptance?

A. I don't recall being present at that meeting, but I do recall being told about it.

Q. Was there more than one meeting with Mr. Morgan to discuss the appropriate allowance for losses?

A. I believe so.

Q. About how many would you judge there would have been?

A. Perhaps two.

Q. Were you at both of them?

A. No, I was at one.

Q. Were you at either of them or was it left to Mr. Lando?

A. I was at one of them, yes.

Q. You were at one and not at the other?

A. Yes, sir.

Q. Were you present at a discussion which Mr. Lando had with Mr. Tramiel and Mr. Kapp at which the question of this guarantee was touched upon?

A. No, sir.

Q. You say that you later heard of the existence of such guarantee. Who told you?

A. I believe—I can't remember exactly who told me—it was either Mr. Lando or Mr. Wagman.

Q. And what were you told?

A. I was advised that there was a guarantee of half a million dollars on the Pro Musica account from Messrs. Kapp and Tramiel.

Q. Personally?

A. Personally."

The "Guarantee" of Tramiel and Kapp

Jack Tramiel was questioned about the "guarantee" in the course of his evidence taken on December 1, 1966.¹

"Q. Before I leave Pearlsound, Mr. Lando gave evidence before the Commission generally to this effect, that when examining the statement of Commodore Sales Acceptance and Aurora as at 31 December, 1964, he had occasion to question the collectibility of a very large sum of

¹Evidence Volume 85, pp. 11525-6.

money, something in excess of a million dollars owed by Pro Musica, and if Pro Musica, as I am informed, dealt closely with Pearlsound Distributors, did it not?

A. Yes. Mr. Morgan started Pearlsound from Pro Musica.

Q. And Mr. Lando testified that he raised some question with Mr. Morgan about the collectibility of the Pro Musica account and Mr. Morgan referred him to you and he spoke to you about the collectibility of the Pro Musica account and touched also on the affairs of Pearlsound, and you and Mr. Kapp stated that the moneys owing by Pro Musica would be found if necessary, and that, up to a sum of half a million dollars, you personally guaranteed it. Did that conversation take place?

A. I don't recall such a conversation just from listening to you. I don't see any reason why I would have guaranteed it—

Q. Is it possible then, that such a conversation may have taken place and you have forgotten about it?

A. I usually don't forget about a half a million dollars guarantee.

THE COMMISSIONER: I wonder if we could have an answer to the question.

A. No, I didn't guarantee any loan. I didn't have a conversation with Mr. Lando about this loan.

MR. SHEPHERD: Do you say there was no conversation at all so far as you recall with Mr. Lando about the Pro Musica loan?

A. That is correct."

I accept the evidence of Messrs. Lando and Fruitman as to their being given some such assurance, at least by Morgan, but I doubt if Tramiel was himself approached and explicitly said what is attributed to him. It may be noted that nothing in writing was asked for or obtained, as would be the normal procedure in the case of such a security, and failure to confirm an assurance by Morgan would be only too characteristic of members of this firm of auditors. The matter was adverted to again at a hearing before the Discipline Committee of the Institute of Chartered Accountants for Ontario, held on November 24, 1967 to consider charges laid by the Professional Conduct Committee of the Institute against Fruitman and Lando that, while engaged as auditors of Commodore Sales Acceptance, Adelaide Acceptance and Aurora Leasing Corporation for the year ended December 31, 1964, they had expressed unqualified opinions on the financial statements of these companies, knowing that the allowances for doubtful accounts were 'grossly understated', failed to perform careful scrutiny of the loan portfolios of the companies and failed to obtain sufficient information to warrant expression of such an opinion. It may be said here that the Discipline Committee found them to be culpable, but that at the

time of writing they have appealed to the Council of the Institute from the Committee's decision and certain proceedings before the Supreme Court of Ontario, ultimately unsuccessful, were taken to challenge the validity of their expulsion from the Institute which the Committee considered to be, together with a fine, appropriate punishment.² A copy of the transcript of the proceedings before the Committee, taken on November 23 and 24, 1967, was obtained from the Institute by this Commission pursuant to order, and the following quotation from Lando's evidence is relevant.³ Mr. C. L. Dubin, Q.C., on behalf of the Professional Conduct Committee, examined Lando and Mr. W. A. Kelly appeared for him; the evidence, although not given under oath, was offered after an expression of the witness's readiness to make a statutory declaration of its truth.

"Q. What was the nature of your discussions with Mr. Fruitman concerning Pro Musica?

A. Mr. Fruitman indicated to me that the account was stagnated, and that the file required some following up. Now in connection with my work with Associated Canadian Holdings, I had come to know the Messrs. Tramiel and Kapp, who were principals of Associated Canadian Holdings, and I had done other spot work on files with which they were connected. This included—

MR. KELLY: Excuse me, just to interrupt for a moment, with respect to Pro Musica, did you discuss any items of security with Mr. Fruitman concerning the Pro Musica account or Commodore Sales?

THE WITNESS: I am coming to that, if I may. Pro Musica and Pearlsound were two companies with which Tramiel and Kapp were associated. This is why I was going out to the property. I would work on the year-end, and see what other information we could get. I looked at the previous year's statement and the available current trial balance, and noted, as Mr. Fruitman did, that there were losses being incurred and no payments being made. I investigated the matter, checked with management, and I was advised at that point that there was a guarantee to the extent of \$500,000.

Q. Who advised you of that?

A. Mr. Tramiel. I think—excuse me, I think Mr. Morgan indicated that to us. I don't remember who told us first.

Q. After Mr. Morgan indicated that to you, did you check with Tramiel and Kapp?

A. Yes, I told them in the presence of Mr. Morgan and Mr. Wagman at that meeting of Associated Canadian Holdings.

²The Council has since confirmed the findings of the Discipline Committee and Fruitman and Lando have been expelled from the Institute.

³Transcript of evidence before the Discipline Committee of the Institute of Chartered Accountants of Ontario re A. M. Fruitman, C.A. and A. M. Lando, C.A. on November 23-24, 1967, pp. 327-8.

Q. What was their answer?

A. That they had in fact guaranteed the loss to the extent of half a million dollars.

Q. Did you say Mr. Wagman did or did not discuss this matter with you?

A. Sorry?

Q. Did he discuss the matter of Kapp and Tramiel with you?

A. He was present at the discussion. I actually followed it up myself.

Q. This was the discussion at which the guarantors acknowledged their guarantee.

A. That is correct."

The True State of Pro Musica

In view of the emphasis in the evidence of all three of Wagman, Fruitman and Lando on the fact that they regarded these large debtors of Commodore Sales Acceptance as "going concerns" and not as "in liquidation", and accordingly considered allowances for doubtful accounts as suggested by Morgan to be adequate, the reference to Fruitman's opinion that "the account was stagnated" is significant. The simplest inquiry would have revealed the fact that Pro Musica was indeed in liquidation. The view expressed by the Commission's accountants as to the proper allowance of the account of Pro Musica to be reserved by Commodore Sales Acceptance at December 31, 1964 according to generally accepted accounting principles, based on the information available to the auditors at the time, was put into evidence by Mr. Orr as part of a general analysis of accounts receivable and bad debt allowance requirements for that date, covering *inter alia* all the accounts receivable of Commodore Sales Acceptance.¹ That portion of the analysis dealing with Pro Musica's debt to Commodore Sales Acceptance is shown overleaf. Even if full effect were given to the proposed guarantee of \$500,000 of the account by Tramiel and Kapp it would appear that a proper allowance in the case of Pro Musica would have amounted to roughly two-thirds of the total amount reserved for doubtful accounts with respect to all the receivables of Commodore Sales Acceptance.

¹Appendix H.

OTHER MAJOR LOANS

COMMODORE SALES ACCEPTANCE PRO MUSICA LIMITED

Balance receivable at December 31, 1964	<u>\$1,139,433</u>
---	--------------------

Latest Financial Report

Prepared by Wagman, Fruitman & Lando—with a disclaimer of audit opinion because of failure to attend inventory count at September 30, 1964.

Major Assets

Inventory	\$381,438
Fixed assets (depreciation \$9,025)	71,893

Major Liabilities

Accounts payable	\$ 167,251
Due to Finance Company	1,114,248
Mortgage payable	12,750
Book value of net tangible assets (deficiency)	(\$ 837,555)
Current position (working capital deficiency)	(\$ 473,400)
Discounted net tangible assets (deficiency) after 50% inventory discount	(\$1,028,000)

Allowance for Bad Debts

In view of the severe and continuing insolvency, the failure to pay interest or principal since 1962, the gross loss on sales of 28 per cent and the net loss on sales of 64 per cent in 1964, this account was viewed on a liquidation basis as follows:

Total assets	\$456,694
Less: Accrued liability for duty	\$ 85,522
Mortgage payable	12,750
Discount inventory—say 50%	190,719
	<u>288,991</u>
Assets available to meet Commodore Sales debenture	<u>167,703</u>
Total due to Commodore Sales Acceptance	<u>\$1,139,433</u>
Allowance required, say	<u>\$975,000</u>

Consideration of the fortunes of Pro Musica may be concluded by observing what happened after the Clarkson Company Limited, as receiver and manager of Commodore Sales Acceptance, took possession of its inventory on July 7, 1965. Inventory valued at \$98,136 was found stored at the premises of Commodore Business Machines and an additional \$96,990 of inventory still in bond in a public warehouse. After negotiating with the Department of National Revenue (Customs & Excise) the Clarkson Company was successful in obtaining a reduction of the normal duty payable of 50% in view of the failure of Atlantic Acceptance Corporation, a remarkable concession

on the part of the Canadian Government authorities; without it, as the receiver reported, recovery on this portion of the inventory would have been "substantially less than the duty charges". Since the inventory had been valued by the company at \$270,000 for the financial statement at June 30, 1965 this very marked reduction in its valuation by the Clarkson Company has been explained to the Commission as the result of ignoring a "parts inventory" of \$25,000, considered valueless, and the deduction of \$50,200 in unpaid duty on goods in bond as not being part of the "paid cost". The receiver was able to liquidate the in-bond inventory after payment of the reduced duty for a net recovery of \$13,700. Its comments on the disposal of inventory generally are significant:²

"After investigating all other alternatives it was decided to liquidate the inventory through Pearlsound on an orderly monthly basis in order to obtain better than the top outside offer of \$12,500. At the same time steps had to be taken to stop immediately the losses of Pro Musica.

To effect this the following arrangements were made with Pearlsound Distributors—

- (a) Pearlsound would continue to buy from Pro Musica but at 10% higher prices, based on landed costs, monthly purchases to be up to \$10,000.
- (b) All sales to be on a C.O.D. basis settled weekly on Fridays by invoice.
- (c) Pro Musica discharged all employees as of July, 1965, the date of receivership.
- (d) Pearlsound would advance and pay all customs, excise and sales taxes on items they purchased from the "in-bond" inventory of Pro Musica. This advance duty payment to be deducted from the billings from Pro Musica to Pearlsound.
- (e) Pro Musica continued to pay storage charges for their inventory on the premises of Commodore Business Machines. A check of outside storage facilities indicated that other storage space would cost an additional \$600 per month.
- (f) An arrangement was made with the Canadian Customs authority whereby we gave them written weekly permission to release specified items from customs through Pearlsound agents who paid all duty charges.
- (g) As a result of this slower but orderly liquidation of the inventory we realized \$90,186 net for the merchandise inventory rather than the \$15,000 to \$25,000 which would have been derived from an early all-inclusive sale in early July.
- (h) However, this method required attendance at the Commodore Business Machines premises several times per week to attend to inventory movements, orders, requisitions, invoicing, etc.

²Exhibit 5124.

- (i) By way of comment only, one wonders why we quite easily and without ingenuity liquidated the \$195,126 inventory thereby reducing the Commodore Sales Acceptance loan by \$90,186 net whereas the Pro Musica experienced management reduced the inventory by \$756,000 in the period from September 1962 to June 30, 1965, but in so doing increased their loan from Commodore Sales Acceptance by \$239,000."

Pro Musica's property at 152 Pearl Street was sold for \$37,500 and it will be recalled that this was encumbered by a first mortgage to the vendors which at the date of receivership amounted to \$10,500. The latest report made by the Clarkson Company, at the request of the Commission on October 17, 1968, showed that Commodore Sales Acceptance had received a total of \$172,320.29 on account of the indebtedness of Pro Musica and that the final loss amounted to \$1,040,-693.66, a calculation which does not take into account the fees of the receiver for protracted supervision and negotiation.

A Benefit Conferred on Commodore Business Machines

Pearlsound, as already noted, had advanced \$50,000 to Pro Musica shortly after its incorporation from the proceeds of the sale of treasury shares to N.G.K. Investments and had in effect forgiven \$10,000 of this amount by setting it up as a deferred development cost, and at June 30, 1962 showed \$45,787 as due from Pro Musica, an amount which does not appear as an asset on the balance sheet at June 30, 1963. The explanation is in part provided by an invoice, dated September 30, 1963, from Pro Musica addressed to Pearlsound for management fees of \$44,275.74¹ which is apparently an attempt to regularize the writing-off of this indebtedness by Pearlsound at an earlier date. Thereafter, according to Vogt, it became standard practice between the companies for Pearlsound to pay the wages of the half-dozen employees of Pro Musica and to have Pro Musica offset the liability thus created by charges for "management fees"; but neither company kept books adequate to support this assertion. At March 31, 1965 Pearlsound owed Commodore Sales Acceptance a balance on its borrowings from that company of \$116,909 and this was paid from an amount of \$124,576.33 advanced to Pearlsound on May 20, 1965 by Trans Commercial Acceptance. On the same day Trans Commercial Acceptance received \$124,500 from Commodore Sales Acceptance. The debt was simply transferred from Pearlsound to Trans Commercial Acceptance, which, according to Draper's evidence, received an assignment of the accounts receivable previously pledged with Commodore Sales Acceptance, and by June 30, 1965 Pearlsound's indebtedness to Trans Commercial had been paid by Commodore Business Machines, setting off by journal

¹Exhibit 3391.

entry the amount owed against Trans Commercial's liabilities to itself, at December 31, 1964 amounting to approximately \$400,000. All of this amount was repaid to the Commodore Business Machines group of companies some three months before Trans Commercial Acceptance was petitioned into bankruptcy, a circumstance which prompted the trustee of its estate to seek relief in the courts. At June 17, 1965 Pearlsound owed Commodore Sales Acceptance only the trifling amount of \$759.40, but Trans Commercial Acceptance owed it \$923,455.98. At the time of the notification from the Clarkson Company on October 17, 1968, referred to above, it had received from the estate of Trans Commercial Acceptance on behalf of Commodore Sales Acceptance a first and final dividend of only \$70,000.

The history of Pro Musica, from the time of its first borrowings of Atlantic funds, throughout the period of its joint management with Pearlsound Distributors by employees of Commodore Business Machines under the direction of Tramiel and Kapp, provides a remarkable example of the close association of Morgan, Walton, Wagman, Tramiel and Kapp in the employment of Atlantic funds for their personal advantage. In previous chapters of the report it has been seen that, through joint participation in Associated Canadian Holdings and trading in the shares of Commodore Business Machines, their stake in the latter company was of vital importance to their personal enrichment, and that they were prepared to go to any lengths to promote its interests at the expense of Atlantic Acceptance Corporation and its subsidiary companies. Since concealment of the losses in these subsidiaries was essential for the preservation of Atlantic Acceptance as a continuing source of funds, the part played by Walton and Wagman and their partners in the accounting firms of Walton, Wagman & Co. and Wagman, Fruitman & Lando was crucial in the grand deception which will be examined at large in Chapter XVI. Although in 1966 Irwin Singer handed over the 2,000 issued common shares of Pro Musica in transferable form to the Clarkson Company, and thus enabled it to secure the appointment of a new board of directors and new officers who would authorize the sale of 152 Pearl Street which the existing directors declined to do, I do not subscribe to the view held by the compilers of the receiver's report on the Pro Musica loan² that Pro Musica was owned by either C. P. Morgan or Commodore Sales Acceptance. It seems clear from the transactions in the autumn of 1962 and the correspondence found in files of the Solomon firm that these shares were intended for Tramiel and Kapp. Tramiel, in the evidence which he gave to the Commission, strongly denied that he and Kapp had any interest in either Pro Musica or Pearlsound and asserted that Morgan merely asked him for help in the management of their affairs. The subsequent history of Pearlsound

²Exhibit 5124.

does nothing to recommend the probability of his story. Morgan may genuinely have believed that, by surrendering control of the situation to Tramiel and Kapp, Pro Musica's huge indebtedness to Commodore Sales Acceptance might be eventually liquidated. If so, he reckoned without their experience in the handling of inventory, and was outmanoeuvred by them on this, as on other occasions.

* * * *

This account of the affairs of companies which were heavy borrowers of Atlantic funds through its subsidiary companies, Commodore Sales Acceptance, Commodore Factors and Adelaide Acceptance, and from Aurora Leasing Corporation, in itself the largest borrower from Commodore Sales Acceptance, does not exhaust the list. As reference to the tables listing the accounts receivable of all these companies will show, there were many other loans outstanding at the date of the receivership of Atlantic Acceptance Corporation which have been referred to only indirectly and which amount in the aggregate to a substantial sum. All of them were dealt with in considerable detail in the evidence given to the Commission by its accounting advisers and other witnesses called before it, and in numerous examinations taken under the Securities Act of Ontario and for discovery under the Bankruptcy Act of Canada. A comprehensive and indiscriminating account of the affairs of all these borrowers would, in my view, unnecessarily enlarge my report without contributing to, or altering in any material way the conclusions which must be drawn from what has been written. One company, Conarm Developments Limited, which borrowed on a scale comparable to that of the companies examined in this chapter, has been reserved for comment in the next, because its financing illustrates the close connection between C. P. Morgan and Wilfrid P. Gregory, president of British Mortgage & Trust Company.

CHAPTER XV

British Mortgage & Trust Company

Background of the Inquiry

In my terms of reference, embracing as they do all the borrowers from and lenders to Atlantic Acceptance Corporation, the affairs of British Mortgage & Trust Company have been especially singled out. It may be argued on the one hand that the operations of this company should be examined only in so far as they involved contractual relationships with Atlantic Acceptance and its subsidiary and associated companies, or on the other that British Mortgage & Trust Company should be isolated and every aspect of its business dealt with at length and in detail so that this section of the report should constitute a record of a virtually separate and distinct investigation. On reflection I have concluded that my responsibility is to consider the function and operations of British Mortgage & Trust Company not merely in the context of its financial dealings with Atlantic Acceptance and its group of satellites but in the larger framework of its general activities as a trust company during the last eight years of its separate existence, and with a view to determining the causes of the catastrophe which overtook it in the summer of 1965 and from which it was rescued, barely short of absolute collapse, by amalgamation with Victoria and Grey Trust Company on terms which left its depositors and guaranteed investors unscathed, but impoverished its shareholders. In the course of this narrative it will be seen that, although there were other elements of weakness not peculiar to British Mortgage & Trust, the main cause of its prostration in a season of high prosperity and commercial activity was its investment in and lending against the securities of Atlantic Acceptance and related companies for which the term "Atlantic complex" may be conveniently used.

Details of many of these transactions have been given and frequently referred to in previous chapters, and perhaps this fact is as good a measure as any of the extent to which the affairs of the trust company and the Atlantic complex were intertwined. As in the case of Atlantic Acceptance, the responsibility of the individual officers of British Mortgage & Trust for the final disaster must be determined and assessed, and the extent to which they were victims of, or themselves produced the circumstances which brought their company to the end of its life and reputation.

The Royal Commission on Banking and Finance which was appointed by the Government of Canada in 1961 to inquire into and report upon the structure and methods of operation of the Canadian financial system under the chairmanship of the late Chief Justice of Ontario, the Honourable Dana H. Porter, and which reported in 1964, had the following to say by way of preliminary comment in its chapter on "Trust and Mortgage Loan Companies":¹

"The earliest ancestors of the mortgage loan companies bore a close resemblance to the caisses populaires and credit unions of today in that they were mutual associations pooling their members' funds for a common purpose. Established like the Quebec Savings Banks in the 1840's, their aim was to lend to those wishing to build homes rather than to make personal loans or invest in securities. These early building societies were "terminating", winding up when each member in turn had taken out and repaid his building loan. In 1855 the first "permanent" society was established, and subsequent legislation clarified the powers of such continuing companies to borrow generally from the public. The mortgage loan companies have since remained in the same specialized business of borrowing by way of debentures and deposits and placing most of their funds in residential mortgages. Trust companies developed more recently, the first one having been incorporated in Ontario in 1882. They carry on an intermediary business similar to that of the loan companies, although placing less emphasis on mortgage lending and more on security investment, but differ from them and other institutions in having the right to act as trustee for property interests and to conduct other fiduciary business. Thus the Canadian trust company is a hybrid, being part administrator managing a great many separate trust and agency accounts and part financial intermediary handling a single pool of funds.

The trust and loan companies have been substantial members of the financial community since their establishment, but rapid expansion and extensive diversification of their activities have brought them new prominence in recent years. Their intermediary business has always been sizable, and from their earliest days has been exceeded only by that of the banks and insurance companies. In the 1920's they

¹Report of the Royal Commission on Banking and Finance: Queen's Printer and Controller of Stationery, Ottawa, Canada 1965, Chapter 10, pp 173-4.

carried about one-half of the mortgages held by private intermediaries, and in the areas of the country where they operated they competed very successfully with the banks for savings. However, during the 1930's and the war years they lost position relative to the banks and other savings institutions. This resulted from the weak demand for mortgages, from the fact that they were not then particularly suited to play a major role in war finance, and from their own conservative reactions to the events of the period following the stock market crash of 1929, during which both they and their trust clients suffered serious losses. Their change of attitude and the dramatic growth of their intermediary business since 1945 thus stands out particularly sharply, while the substantial post-war increase in their traditionally important estates, trust and agency business has contributed further to the renewed attention which the trust companies have been attracting. The fact remains, however, that it was not until the early 1960's, when the trust companies grew particularly vigorously, that the ratio of their size to that of the banks surpassed 10%, the level at which it had stood at the beginning of the 1930's. The loan companies, which were as large as the trust companies three decades ago, have grown less over the period as a whole despite their rapid gains since the end of the war."

The first building societies appeared in England towards the close of the eighteenth century and developed rapidly during the first half of the nineteenth, being recognized and to some extent organized under the Friendly Societies Act of 1834. By a further enactment in 1874 members of building societies were granted the protection of limited liability and the societies themselves that of incorporation, but many continued to act through trustees thereafter. The right to borrow money from the public was also conferred at this time and the legislation applying to the United Kingdom was in due course reproduced in Ontario, the final enactment being the Upper Canada Building Societies Act of 1846, amended in 1859 to permit perpetual life and the taking of deposits. Permission to borrow by issuing debentures was conferred by an amendment in 1874.

Although the name "Building Society" is still widely used in Britain by companies with large assets which no longer confine their activities to mutual assistance of members for the building of their own homes, the term "loan company", or "mortgage loan company", has been generally adopted in this country, and in the United States, where the development has been similar to that in Britain and Canada, the term "Building and Loan Association" was used at an early stage. The trust company, on the other hand, was apparently a purely American invention and was at first a fiduciary corporation, created by state rather than federal legislation, for purposes not pursued by the regular banks. Its original function, and the one which gave it its name, was to act as trustee for individuals,

estates and corporations, but the function of trustee was soon extended to receiving deposits from members of the public, payable on demand and upon which interest was paid. Not all deposits were payable on demand, some being made for a term on which a higher rate was allowed, and out of this has grown the substantial trust company business of borrowing funds from the public against the issue of guaranteed investment certificates. A large part of the business of American trust companies, also developed by many, although not all, of their Canadian counterparts, is done in their capacity as agent for public corporations in the issue, transfer and exchange of their securities, a highly organized service, cheaper and more convenient than individual corporations could provide for themselves. Another specialized function of trust companies, of diminishing importance in the United States but still much resorted to in Canada, arises from their fiduciary function and consists of their acting as trustees for lenders to other corporations holding bonds, debentures or notes as evidence of debt under indentures charging or mortgaging assets of the borrowers in favour of the trustee, and imposing certain duties and obligations upon it to be exercised in favour of the lenders, particularly in the case of default by the borrower. This function, which is simply another facet of the trust company's fiduciary activities and is performed by many though not all Canadian trust companies, is of particular importance in this inquiry, but not in so far as it deals specifically with the affairs of British Mortgage & Trust Company. Generally speaking, the trust company, because of its perpetual life and superior organization, has displaced the individual executor and trustee from the duties which practising lawyers and other men of business have long been accustomed to discharge. At the same time the Canadian trust company, as the Porter Commission noted, has through its deposit-taking and lending functions come into increasing competition with the chartered banks in the conduct of financial business.

On October 5, 1877, before the days of trust companies in Canada, the British Mortgage Loan Company of Ontario was incorporated in Ontario, pursuant to the provisions of the Joint Stock Companies Act, "for the purpose of lending money on real securities and such other securities as the By-laws of the Company may prescribe." The amount of capital stock was fixed at \$5,000,000 consisting of 50,000 shares each with a par value of \$100. Originally the "chief place of business" of the new company was fixed at the City of London in the County of Middlesex, but by by-law No. 20, enacted on November 26, 1878, this was changed to the Town of Stratford in the County of Perth.² The company was therefore a mortgage loan corporation and remained so during the first half-century of its existence; but by a provincial order-in-council

²Exhibits 4226 and 4228.

dated August 19, 1925 it was provided that "trustees be authorized to invest trust funds in the terminable debentures of the said The British Mortgage Loan Company of Ontario and to make deposits with the said company." In the following year by an "Act Respecting The British Mortgage Loan Company of Ontario"³ its name was changed to the British Mortgage and Trust Corporation of Ontario and it was vested with the powers of a trust company under the Loan and Trust Corporations Act.⁴ By a further order-in-council, dated December 22, 1931, the company was approved as a trust company "with which trustees may entrust trust funds for guaranteed investment", and finally in 1958 the Act of 1926 was apparently "amended" by order-in-council dated May 8 changing its name to British Mortgage & Trust Company. The last of these orders affecting British Mortgage & Trust Company, before that which permitted its amalgamation with Victoria and Grey Trust Company on September 16, 1965, was one dated January 24, 1963 confirming the company's by-law No. 43 which divided each \$100 share into 20 shares having a par value of \$5 each.

A brief sketch of the history of British Mortgage & Trust was provided on the occasion of the opening of the company's new building in Stratford in 1962:⁵

"British Mortgage & Trust Company was begun in 1877 by a small group of district business men. In December of 1878, the directors moved the office of the fledgling company to Stratford. Seven additional Directors, whose names are important in the history of the area, were appointed—Messrs. Andrew Monteith, James Corcoran, James Trow, Thomas Ballantyne, William Buckingham, Henry Puddicombe and John Youngs. In 1879, a savings department was added and deposits in the first year exceeded \$50,000. Manager of the Company was Mr. William Buckingham, who held the position until 1914.

Office premises were rented until 1895 when a building at 27 Downie Street (then known as Market Street) was purchased. Simple and modest as the building may have been by today's standards, the Stratford Beacon described it as 'spacious and tasteful and likely to meet the Company's needs for many years to come.' Seventeen years old, the Company now had a paid-up capital of over \$314,000, over \$528,000 in deposits and a reserve fund of \$84,000.

In 1914, Mr. J. A. Davidson took over the management of the Company and served until ill health forced him to retire in 1924. Succeeding him, his son-in-law, Mr. W. H. Gregory, took on the duties as general manager.

The little building at 27 Downie Street served well for nearly fifty years, but expanding business demanded larger quarters. In 1925,

³16 Geo. V. c. 121.

⁴R.S.O. 1914 c. 184.

⁵Exhibit 5087.

the Merchants' Bank building at 10 Albert Street was purchased. Under Mr. Gregory's leadership, extensive renovation transformed the office to one that was very much ahead of its time.

In 1926, the Ontario Government granted the Company a charter to operate as a trust company and the name was changed to 'The British Mortgage & Trust Corporation of Ontario'.

Growth of the Company continued steadily with absolute safety of the people's money as the primary consideration. On the 75th Anniversary, in 1952, the Company had over \$17,000,000 in public funds with general reserves of \$1,000,000 to equal the paid-up capital of \$1,000,000.

In January, 1957, Mr. Wilfrid P. Gregory, Q.C., senior partner in a Stratford legal firm, was appointed Managing Director, replacing his father who retired as Managing Director but continued as President of the Company.

The long name of the Company had always been found bulky and cumbersome and in the 80th year of the Company's history, the name was shortened to 'British Mortgage & Trust Company'.

Expansion of the Trust Department was planned in 1958 with the appointment of Mr. J. M. Armstrong, Q.C., of Toronto, as Assistant General Manager and head of the Trust Department.

A new surge in the Company's growth demanded more space, and in 1958 the site on the corner of Ontario and Church Streets, Stratford, with adjoining property on Erie Street, was purchased. Messrs. Rounthwaite & Fairfield, winners of the Massey award for their design of the Festival Theatre, were engaged as architects. The first sod for the new Head Office building was turned in December, 1960, by Stratford's Federal Member, Hon. J. W. Monteith, Minister of Health and Welfare, who was a grandson of the late Andrew Monteith, M.P., the first President of the Company. The foundation stone was laid by the President, Mr. W. H. Gregory, on October 5, 1961, the 84th anniversary of the founding of the Company."

Originally the affairs of the company were to be managed by a board of not less than three directors as provided by the letters patent but in 1879 the number was increased to eight, in 1930 decreased to seven, restored to eight in 1963, and finally raised to nine in 1964. The quorum, which had been reduced from five to four when the number of directors was changed from eight to seven, remained at four throughout the subsequent increases in number. As might be expected of a company carrying on business in a county town of moderate size set in the midst of some of the fairest farm lands in Ontario and without any branch offices until its latest years, the directors were invariably local men of substance and high repute. Although from the earliest days of the company's history there was provision in the by-laws for the appointment of a loan committee and an executive committee, these functions were by and large

performed by all the directors, and it was not until 1959 by the passing of by-law No. 41, enacted on November 10,⁶ that an executive committee was set up to be elected by the board of directors. Paragraph 3 read as follows:

"During the intervals between the meetings of the Board of Directors the Executive Committee shall possess and may exercise (subject to any regulations which the Directors may from time to time make) all the powers of the Board of Directors in the management and direction of the operations of the Company (save and except only such acts as must by law be performed by the Directors themselves) in such manner as the Executive Committee shall deem best for the interests of the Company in all cases in which specific directions shall not have been given by the Board of Directors. All action by the Executive Committee shall be reported to the Board of Directors at its meeting next succeeding such action."

Previous to this enactment the whole board had sat in "executive session" almost weekly, but not often more than quarterly for its formal meetings. After by-law No. 41 had been passed and confirmed by the annual meeting of shareholders on December 15, 1959, the board appointed all its members who were in office on November 1 of that year to the executive committee, excluding only S. K. Ireland who was appointed a director on the day the by-law was enacted and who, as a retired manager of the Perth Mutual Fire Insurance Company, was better qualified than some of his fellow-directors to be a member. The executive committee met weekly, chiefly to approve the applications for mortgages and investments upon which it reported to the regular meetings of the board which thereafter appear to have occurred monthly to consider and approve the transactions of the executive committee. The idea of a separate loan committee which had been provided for in the earliest days by by-law No. 4⁷ was revived by a minute of the executive committee of December 24, 1963, providing for the establishment of a mortgage loan committee consisting of the chairman of the board, Mr. W. H. Gregory, the president and managing director, Mr. W. P. Gregory, Q.C., the assistant general manager and secretary, Mr. J. M. Armstrong, Q.C., all of whom were directors, and Mr. W. A. Pike, the assistant secretary and mortgage manager, whose transactions with Donald W. Reid of London have previously been described.⁸ This committee was authorized to approve or reject applications of mortgage loans of less than \$15,000 and any two of its members constituted a quorum.

⁶Exhibit 4228.

⁷Exhibit 4228.

⁸Chapter VII.

BRITISH MORTGAGE & TRUST

From 1952 until July 27, 1965 the officers and directors of British Mortgage & Trust Company were as follows:⁹

Chairman	—W. H. Gregory (from December 17, 1963)
President	—W. H. Gregory† (to December 17, 1963) —W. P. Gregory, Q.C. (from December 17, 1963)
Executive Vice-President	—W. P. Gregory, Q.C. (from November 19, 1959 to December 17, 1963)
Vice-President	—C. E. Moore (to November 2, 1959) —Dr. H. W. Baker† (to January 4, 1964) —A. B. Manson (from January 7, 1964)
Managing Director and Treasurer	—W. P. Gregory, Q.C.† (from January 1, 1957)
Assistant General Manager & Secretary	—J. M. Armstrong, Q.C. (from September 1, 1958)
Directors	—Dr. H. W. Baker† C. E. Moore A. B. Manson W. H. Gregory*† Dr. H. B. Kenner*† W. P. Gregory, Q.C.*† John R. Anderson, Q.C.† (from April 20, 1955) S. K. Ireland (from November 10, 1959) J. M. Armstrong, Q.C. (from December 17, 1963) Brig. J. S. H. Lind, D.S.O., E.D. (from January 7, 1964) H. R. Lawson (from December 16, 1964)

*Elected Director prior to 1952

†Member of Executive Committee of Board of Directors (established by by-law No. 41, November 10, 1959)

⁹Exhibit 4227.

W. H. Gregory had become the third manager of the company on December 1, 1924 in succession to his father-in-law, the late J. A. Davidson. He had been called to the bar in 1907 and had practised as a barrister and solicitor in Mitchell, Kitchener and Stratford during the intervening years. He served under two presidents, the Honourable Nelson Monteith and Mr. L. M. Johnston, neither of whom appears to have been paid a salary but received a modest honorarium at the end of each year which in the case of Johnston, who succeeded Monteith in 1949, amounted to \$1,000 per year, voted by resolution of the annual meeting of shareholders, together with \$500 for each of the vice-presidents. W. H. Gregory was in fact the life and soul of the company and ruled its affairs, if report be true, with a firm hand. Johnston died in his seventy-seventh year in April 1955 and was succeeded as president by W. H. Gregory who combined this office with that of managing director held since his appointment to the board in 1925. On June 27, 1956 he asked the board of directors for leave to retire from the office of managing director on January 1, 1957. Since he was entitled to retire on full pension on April 1, 1957, the board granted him six months leave of absence with full pay, beginning on January 1 in 1957, and allowed him \$500 per month while he continued in office as president of the company. This he did until a meeting of the board held on December 17, 1963, when he resigned and was succeeded by his son, Wilfrid P. Gregory, Q.C., who had been managing director from the time that his father relinquished that office. Thereafter W. H. Gregory was annually re-elected chairman of the board of directors and held this office until the merger of British Mortgage & Trust Company with Victoria and Grey Trust Company.¹⁰

Wilfrid Palmer Gregory was born in Stratford, Ontario on February 2, 1912, attended the Stratford public and secondary schools, graduated from the University of Toronto as a Bachelor of Arts in 1933 and completed his education at Osgoode Hall Law School from which he was called to the bar of Ontario in 1936. From that time forward he practised his profession in Stratford until 1942 when he joined the Canadian Army, serving in Canada and overseas and holding the rank of captain at the time of his discharge in January of 1946. He had been an alderman of Stratford from 1938 to 1941, was re-elected after his return from active service in 1946 and 1947 and again in 1952, serving as mayor of the city in 1955 and 1956. From 1954 to 1956 he was president of the Ontario Liberal Association, becoming vice-president of the National Liberal Federation in that year. He was also active in the affairs of the Canadian Bar Association, being vice-president for Ontario in 1954 and 1955. In 1951 he had become a bencher of the Law Society of Upper Canada and, on being elected in 1966 for his fourth five-year term, became a bencher for life. In addition, his work for the Stratford Festival

¹⁰Exhibit 109.

Foundation, of which he became president, and for the Stratford Industrial Commission, of which he was also president for five years, won universal applause. It is not surprising that in the course of so much activity, when he was approached in June 1956 to succeed his father as managing director of British Mortgage & Trust Company of which he had been a director since 1949, he expressed some reservations and made what amounted to terms with the board as expressed in the minutes of their meeting of June 27:¹¹

“Mr. Wilfrid P. Gregory explained his attitude to the proposal that he discontinue his established and remunerative legal practice which assures him a substantial income in addition to freedom of action and scope for his personal ambition. If he did so, it would be for two paramount reasons; firstly, from a sentimental desire to carry on the work of his father and grandfather and, secondly, because of the challenge presented by the possibility of further progress of the Corporation. In fairness to himself, he would need an assurance of adequate remuneration at the time of assuming the position and thereafter as justified by the results which may be achieved. He emphasized the importance of the stock-option plan as a means of remunerating executives and senior members of a corporation’s staff.”

Accordingly it was resolved by a standing vote, in which Messrs. W. H. and Wilfrid P. Gregory did not participate, that the latter be appointed managing director, secretary and treasurer of the company from January 1, 1957, and that his salary be \$20,000 for the year 1957, with a guaranteed annual increase of \$2,000 for each of the next ensuing five years. His right to accept directorates in other companies and retain for his own use the fees thereof, and to “continue to hold offices of honour or preferment to which he may be elected or appointed,” was explicitly recognized and the board went on to provide, pursuant to by-law No. 38 of the company, that “1,000 shares of the unissued capital stock of the Corporation shall be set aside on January 2, 1957 and that Mr. Wilfrid P. Gregory, Q.C. shall have the right to purchase all or any of such shares at a price of \$215 per share at any time thereafter but not later than December 31, 1966.” This was a valuable privilege, since after it was split twenty shares for one, the new stock sold as high as \$40 per share in 1964, and the new managing director was in due course to avail himself of it as will be seen. At the same time it was provided that he could act as “corporate solicitor” at his discretion and receive such fees as might be payable for these services, a right which does not seem to have been exercised except in the case of those exigible on discharge of mortgages by the company which had been habitually paid to his father in the past. For a small trust company operating in a community of little more than 20,000 people, with only some twenty employees and with no branch offices, this provision

¹¹Exhibit 109, pp. 78-9.

made a dozen years ago can only be described as princely, and indicates the high regard in which the new managing director was held and the confidence of his board, explicitly expressed at the time, in his ability to carry on the traditions of the company as maintained by his father and grandfather.

From this point onwards Wilfrid Gregory took complete charge of the company, although his father continued to preside at meetings of the board and meetings of the executive committee. When the former gave evidence before the Commission on April 26, 1967 he described the situation thus:¹²

“Q. . . . To what extent was Mr. W. H. Gregory, the president of the company, the principal operating officer, (at) the beginning of 1957?

A. These terms are always a little nebulous in business, but in actual fact while he was president of the company I made all of the decisions and recommendations to the board, and he was prepared to give me all the assistance I wanted, but I will say for him that he took the very difficult position of never forcing a decision on me, or making any suggestion unless I asked him. He left it to me to run the company.

Q. What is Mr. Gregory's, senior, present age?

A. He was eighty last December.

Q. So I take it, that when you became managing director, Mr. W. H. Gregory had attained the age of seventy, and he was thereafter not very active in the business of the company?

A. That is correct, decisions bothered him more than it used to.”

By 1964, according to the evidence of Mrs. Gail Hottot, who was Wilfrid Gregory's private secretary at the time, the chairman's daily activities had been much reduced, as one might expect from his advanced years.¹³

“Q. How active was Mr. Gregory during your employment with this company insofar as you could judge from the amount of time he spent in the office?

A. Mr. W. H. Gregory, I would say he never came in to the office till the afternoon and he really didn't do very much at all. He got very little mail and he would look over a few mortgages each day then go back home early before the day was over.

Q. Did he have a secretary of his own?

A. Not really, there was a girl who did the odd job for him, but he really didn't have a secretary.

Q. Then would you say that it would be fair to say he did not appear to be active when you were there?

A. No, he didn't.”

¹²Evidence Volume 115, pp. 15509-10.

¹³Evidence Volume 118, p. 16129.

In the period following the Second World War British Mortgage & Trust Company had two vice-presidents and their positions were filled by directors. C. E. Moore, a district manager of the Canada Life Assurance Company in Stratford, had been a director of the company since 1934 and was appointed a vice-president in 1955. He died in office in 1959 in his eighty-fifth year and his place as vice-president was taken by Wilfrid Gregory who was given the title of executive vice-president. Dr. H. W. Baker was a dentist in Stratford who had been a director of the company since 1930, being appointed a vice-president in 1949 and holding the position until his death in 1964 at the age of 89. Dr. H. B. Kenner, a well-known physician who had commanded a military hospital during the Second World War, was 69 in 1965 and had been a director since 1938. John R. Anderson, Q.C., who was called to the bar in the same year as Wilfrid Gregory and had been his partner, was a leading practitioner in Stratford and was appointed a director in 1955. His firm of Anderson, Neilson, Bell, Dilks & Misener were general solicitors for British Mortgage & Trust and, when the company's new and impressive building was opened in Stratford, carried on business in these premises. A. B. Manson had been City Engineer and manager of the Public Utilities Commission in Stratford, and when he died in 1966 was reputedly 83 years old.

The appointment of Brigadier J. S. H. Lind, D.S.O., E.D., on January 7, 1964, and H. R. Lawson, F.S.A., on December 16, 1964, represented a departure in that neither of them were residents of Stratford. Brigadier Lind was a distinguished Canadian soldier who had grown up in the service of the St. Marys Cement Company, founded by his father, of which he was president at the time of his appointment. Lawson was from Toronto, was an actuary, and at the time was president of the National Life Assurance Company of Canada: he represented not only his own substantial personal investment but those of others connected with his company. Both these directors attended very few meetings of the board before the collapse of Atlantic Acceptance affected the trust company's affairs, Lind because of ill-health and Lawson on account of the lateness of his appointment; but Lawson succeeded Wilfrid Gregory as president on July 27, 1965 and played a leading part in the transactions which culminated in the merger with Victoria and Grey Trust Company. Neither of these experienced business men was a member of the executive committee, nor was J. M. Armstrong, Q.C., assistant general manager and head of the trust department, who came to the company in 1958 and was appointed a director in 1963. Armstrong, however, attended the meetings of the executive committee from its constitution in 1959 and reported on the affairs of estates, trusts and agencies. He had been called to the bar of Ontario in 1935 and was an

experienced trust officer, having been employed by the London & Western Trust Company and the National Trust Company in that capacity for over twenty years. Another attendant at the weekly meetings of the executive committee was W. A. Pike, mortgage manager and assistant secretary.

By the time the staff of the Commission commenced its examination of the affairs of British Mortgage & Trust it had been merged with Victoria and Grey Trust under a new incorporation which retained the name of the latter. The assistance given by officers of this company, some of whom were former employees of British Mortgage & Trust was prompt, conscientious and helpful, and should here be acknowledged, because considerable disruption of their daily work and disturbance of their records were inevitable and, on the whole, were borne without complaint. Mr. F. E. A. Jackson, C.A., formerly an examiner on the staff of the Registrar of Loan and Trust Corporations, did preliminary work for the Commission during this period. A searching and comprehensive examination of the company's corporate records and books of account was conducted by and under the direction of Mr. A. W. Moreton, C.A., partner in the firms of Touche, Ross, Bailey & Smart and P. S. Ross & Partners, who gave evidence to the Commission on April 5, 6 and 7, 1967.¹⁴ This, requiring three full days and filling some 400 pages of transcript and the submission of numerous schedules and documents, was by no means all that was offered by counsel as will be seen, but it was the kernel of the inquiry and must be examined at length.

Expansion under W. P. Gregory

Generally speaking, the period under detailed consideration extended from January 1, 1957, the day on which Wilfrid P. Gregory assumed the responsibilities of managing director, to July 27, 1965 when he resigned from all his offices in the company and ceased to have any voice in the management of its affairs. During the eight and a half years which elapsed between these dates British Mortgage & Trust more than kept pace with the general expansion of business experienced in Ontario, and indeed across Canada, on a scale perhaps never before equalled, and the company was changed almost beyond recognition both in size and character under his sole and untrammelled direction. The story of the company's financial progress is illustrated by Table 60¹ which shows comparative balance sheets at the fiscal year-ends from 1957 to 1964 prepared from the published financial statements of the company, together with balance sheet figures at June 30, 1965 prepared from an internal statement made without audit and comparative statements of revenue and expenditure and undivided profits for the same period shown

¹⁴Evidence Volumes 107-9.

¹Exhibit 4230.

as Table 61.² In addition to the published financial statements,³ the annual statements made to the Registrar of Loan and Trust Corporations, as provided by law and annually submitted by all companies under his jurisdiction, were resorted to and these contain more detail particularly in the treatment of reserves than do the published statements.⁴ At December 31, 1957, at that time the end of the company's fiscal year, the total assets of British Mortgage & Trust Company were approximately \$24,900,000 and total shareholders' equity consisting of capital stock, general reserve fund and profit and loss amounted to \$2,520,627. The earnings after tax for that year amounted to \$188,809 giving a net return of 7½ % of the total equity. Looking forward to the last full year referred to in comparative balance sheets which ended October 31, 1964—the change in the year-end date was authorized by amendment to the Loan and Trust Corporations Act in 1959—the assets as reported by the company had grown to \$106,616,515 and the equity to \$5,279,240. Earnings for the year were reported as \$444,798, or just under 8½ % of the equity, but this amount was fixed upon as the result of accounting treatment which must be scrutinized in due course.

One class of assets appearing in 1964, but not present in 1957, was that of short-term notes, first bought by British Mortgage & Trust Company in 1960 in the amount of \$500,000 and amounting in 1964 to \$4,326,889, or 4.06 % of the total assets. The company followed the practice of describing as short-term notes promissory notes falling due either upon demand or in less than one year. Another novelty was the appearance of collateral loans, or, as described in the balance sheet, "loans secured by G.I.C.'s stocks or bonds", which appeared for the first time during the year ended October 31, 1962 in the amount of \$511,570 and were made to individuals or corporations against a promissory note and collaterally secured by the deposit of marketable securities. By the end of 1964 these loans had grown to \$2,768,465 and by June 30, 1965 to \$4,335,265. Out of \$511,570 recorded at the year-end in 1962 \$480,000 was a loan made to C. P. Morgan, president of Atlantic Acceptance Corporation. His board had been joined by Wilfrid Gregory on April 10, 1959. The loan represented 80 % of the purchase price of 25,000 second preference shares of Atlantic Acceptance which were pledged with British Mortgage & Trust as collateral security. Without over-emphasizing the nature of the security it may be said that this loan was typical of those made in this category.

A third example of change in the character of the company's assets is provided by the appearance of "real estate held for investment, less reserve" and "real estate held for sale, less reserve". In 1960 the company began the practice of purchasing for its own account real estate on which

²Exhibit 4231.

³Exhibits 4248-55.

⁴Exhibits 4232-40.

buildings were erected and leased to others in the type of transaction known as "leaseback". This type of asset had grown modestly to \$745,615 by the end of October, 1964. Real estate held for sale, however, represented properties on which the company had foreclosed in its capacity as mortgagee. It appeared first in the balance sheet for the year 1962 in the amount of \$509,055, increasing by 1964 to \$2,716,848. Immediately below these items in the column of assets appears "premises, less reserve". In 1957 British Mortgage & Trust held these to a valuation of only \$35,917. In 1964 this amount had grown to \$2,351,687, an increase effected by the construction of the new head office building in Stratford at a cost of \$1,400,000 and the construction of a number of branch offices. In this connection it should be observed that section 145 of the Loan and Trust Corporations Act limited a registered loan corporation or trust company's right to such real estate in the following terms:

"A registered corporation may hold to its own use and benefit such real estate as is necessary for the transaction of its business, or is acquired or held *bona fide* for building upon or improving for that purpose, and may sell, mortgage or dispose of such real estate."

However, by section 146 it is provided that:

"A registered corporation, when so authorized by its letters patent or by the Lieutenant Governor in Council, may acquire or may construct, on any lands held pursuant to section 145, a building larger than is required for the transaction of its business and may lease any part of the building not so required."

The permission contemplated by section 146 had been obtained by British Mortgage & Trust Company by orders-in-council issued in 1961 and 1962.

Throughout the period under consideration the loans made by the company against mortgages of real estate grew with great rapidity in relation to its previous history, but steadily and without fluctuation. At December 31, 1957 they amounted to \$19,767,922 or 79.4% of the company's total assets; by October 31, 1964 they represented 71.69% of the total assets in the amount of \$76,439,377. The growth in mortgage assets appears to have been in the order of 20% per year of the previous year's figure until 1963 and 1964 when the rate of increase was accelerated, and this tendency continued in the first six months of 1965 where the increase over the figures for 1964 amounted to upwards of 15%. At the same time it must be borne in mind that the valuation of mortgages in 1964 is not comparable to the figure reported in 1963, because the former includes accrued interest receivable which was not the case in the previous year. The change in accounting treatment from

a cash to an accrual basis and the preparation of the financial statement for 1964 affected all the interest-bearing assets and also the calculation of reserve and profit and loss.

The Auditors' Report under the Loan and Trust Corporations Act

At the time that the financial statement for the year 1964 was produced the auditor of the trust company was Gordon D. Campbell, F.C.A. of Campbell, Lawless & Punchard, a Toronto firm which had been for many years associated with the audit, and A. Brock Monteith, C.A. of Monteith, Monteith & Co. of Stratford. Monteith's appointment occurred in 1958 but Campbell had been one of the company's auditors, according to the testimony of E. J. Black, C.A.,¹ a member of his firm who had actually done the auditing work in the post-war period, for some thirty-five or forty years. Although Monteith had done the detailed work on the audit for two or three years after his appointment it had by 1964 been taken over by his partner J. A. Meldrum, C.A. who had left the firm and was out of the jurisdiction when Monteith testified before the Commission on May 17, 1967.² In accordance with the provisions of section 68(2) of the Loan and Trust Corporations Act, the auditors, as they had done for many years past, only expressed an opinion on the company's balance sheet and not on the operating statement. Section 68, which deals with the auditors' examination and report, right of access to records and right to attend shareholders' meetings, reads in respect of its second subsection as follows:

"The auditor shall make a report to the shareholders on the balance sheet to be laid before the corporation at any annual meeting during his term of office and shall state in his report whether in his opinion the balance sheet referred to therein presents fairly the financial position of the corporation."

Since the common practice of auditors in the case of companies generally is to express an opinion on both parts of the statement, this statutory provision requires examination. Section 68 was enacted first as section 66b in Ontario, as recently as 1960 by 8-9 Elizabeth II c.61, and repealed a provision of the Act which had stood since 1919 as part of section 4, prescribing the contents of the general by-laws of a trust company in the following form:

"They shall require that there shall be mailed or delivered to each shareholder, at least two weeks before the annual meeting, a statement, verified by the auditors, of the assets and liabilities and income and expenditure of the corporation to a date not more than two months before the meeting, such statement to be drawn in accordance with the form from time to time prescribed by the Registrar."

¹Evidence Volume 122.

²Evidence Volume 122.

Prior to this, from 1912, when the first Loan and Trust Corporations Act, combining statutes dealing separately with loan corporations and trust companies, was enacted as 2 George V, c.34, the corresponding subsection had provided:

"They shall require that there be delivered to each shareholder before the annual meeting, a financial statement, verified by the auditors, showing fully and truly the income and expenditure, (including the expenses of management) of the corporation for the period audited and the liabilities and assets of the corporation at the date of the statement."

Thus in 1960 the shareholders and the general public had been deprived of the opinion of the auditors as to whether the statement of income and expenditure, with its important relationship to the state of the company's reserves, fairly presented the results of the company's operations in accordance with generally accepted accounting principles on a basis consistent with that of the previous year. Although it might be considered unprofitable to examine the reasons which were used to justify the amendment of 1919, that of 1960 is explained by a submission of the Institute of Chartered Accountants of Ontario to the Attorney General in November, 1959.³ The following extracts set out the position of the Institute which had established a committee to report on the audit sections of the Loan and Trust Corporations Act:

"The present Act incorporates unchanged provisions of long standing relating to auditing requirements. In the light of experience these provisions may be considered generally satisfactory, but there are a number of respects where, in our opinion, improvements can and should be made.

In our deliberations we have recognized that the position of loan and trust corporations has many similarities to that of the Chartered Banks in Canada. A sound financial system is vital to the nation's economy, and just as with the Chartered Banks the interest of the shareholders of loan and trust corporations in the stability of these institutions is identical with the interest of the public as a whole. The stability of these institutions is, however, itself dependent upon public confidence and they must, therefore, in the national interest, take every proper precaution to preserve that confidence. It is for this reason that in good times loan and trust corporations make provision for losses on securities, mortgages and other assets which they may experience in bad times to come. This is a form of cyclical accounting designed to parallel the operation of the economic cycle with which the business of financial institutions, more than any other business, is by its very nature so closely related. We therefore concur in the long existing practice of Canadian loan and trust corporations not to make public information respecting the reserves established by them for contingencies. A similar view was expressed by the Cohen Committee on the British Company Act in 1945, as indicated by the attached Appendix 1."

³Exhibit 4256.

Annexed to the Committee's report was an excerpt from the Report on Company Law Amendment made in 1945 in the United Kingdom by the Right Honourable Lord Justice Cohen:

"APPENDIX 1

101. Undisclosed reserves. The chief matter which has aroused controversy is the question of undisclosed or, as they are frequently called, secret or inner reserves. An undisclosed reserve is commonly created by using profits to write down more than is necessary such assets as investments, freehold and leasehold property or plant and machinery; by creating excessive provisions for bad debts or other contingencies; by charging capital expenditure to revenue; or by undervaluing stock in trade. Normally the object of creating an undisclosed reserve is to enable a company to avoid violent fluctuations in its published profits or its dividends.

The objections urged against undisclosed reserves can be summarised as follows. As the assets are undervalued or the liabilities overstated, the balance sheet does not present a true picture of the state of the company's affairs; the balance of profit disclosed as available for dividends is diminished, and the market value of the shares may accordingly be lower than it might otherwise be; and the creation, existence or use of reserves, known only to the directors, may place them in an invidious position when buying or selling the shares.

On the other hand, if there is no detailed disclosure in the profit and loss account, undisclosed reserves accumulated in past periods may be used to swell the profits in years when the company is faring badly, and the shareholders may be misled into thinking that the company is making profits when such is not the case. Such abuses are rare, and, in general, directors have concealed reserves from shareholders in the belief that such concealment is in the interests of the company. None the less the practice has the unfortunate result that shareholders and investors and their advisers have not the information to enable them to estimate the real value of the shares.

We do not believe that, if fully informed, shareholders would press for excessive dividends and we are in favour of as much disclosure as practicable. It is also important in our opinion to ensure that there should be adequate disclosure and publication of the results of companies so as to create confidence in the financial management of industry and to dissipate any suggestion that hidden profits are being accumulated to industrial concerns to the detriment of consumers and those who work for industry. We have framed recommendations with which we think most companies should comply (pages 59-60).

There are, however, three classes of companies where other considerations must be taken into account, namely banking companies, discount companies and assurance companies (we use the term 'assurance companies' to cover both assurance and insurance companies). In the case of banking and assurance companies the interests of the deposi-

tors and the policy-holders respectively outweigh the interests of the shareholders and in the case of all three classes of companies considerations affecting the public interest must be taken into account. The reputation for stability of these companies is a national asset of the first importance to the community in general and it is not in the public interest to endanger their stability or the confidence they enjoy at home and abroad. From time to time the values of their assets and particularly their very large holdings of Government and other gilt-edged securities are adversely affected by political disturbances and economic conditions, national and international. In such circumstances it is desirable that their financial strength should be even greater than may appear. The history of the years after 1929 demonstrates the public advantage of their being able to present a reasonably stable position in a time of violent and sudden stress and for this reason it seems to us desirable that such companies should be permitted to retain a buffer of undisclosed reserves. In this country no one questions the stability of our banks, discount companies and assurance companies, but some countries are not so happily placed and countries abroad watch the evidence of stability very closely and react very quickly to any unusual symptoms. We consider, therefore, that banking and discount companies should be absolved from the obligation of showing separately reserves and provisions and transfers to and from such accounts, but that their balance sheets should indicate the existence of reserves and provisions and their profit and loss accounts should be appropriately worded so as to show whether any such transfers have been made during the period covered by the accounts."

This, then, was the case for not requiring financial institutions such as loan and trust corporations to disclose to the public the detail of their operating statements because such disclosure would necessarily include information respecting their reserves, and in 1960 the Legislative Assembly duly complied with the prevailing view. These documents make strange reading when the tide is setting in the opposite direction and massive disclosure, launched upon the public in unprecedented profusion, is the order of the day.

The Accounting Change in 1964

The amendment of 1960, which produced sub-section (2) of section 68, in fact simply regularized the practice of accountants which had prevailed for many years in the case of auditors' opinions given on the financial statements of chartered banks, insurance companies and loan and trust companies. The by-laws of British Mortgage & Trust Company, as far back as 1956, do not contain any requirement that the statement of income and expenditure should be reported on by them. The relevance of this special treatment of loan and trust corporations may be illustrated

by the result of a change in treatment by the company of interest receipts which took place in preparing the financial statements for publication in 1964. Before that year it only took into account as income what it had received and was accordingly operating on what is known for accounting and taxation purposes as a cash basis. On the other hand, interest owed by the company to others was a liability and was so recorded, even though it had not yet fallen due to be paid; it was calculated on what is known as an accrual basis. This practice was not common and must be considered most conservative, since only four of the thirty-two trust companies so reporting in Ontario carried out the same method of accounting. In 1964 the practice was abandoned by British Mortgage & Trust and a change was made to reflect as income during that year moneys accruing due, for example, on account of mortgage loans which had not yet become payable at the year-end of October 31, or in other words, interest which was attributable to the use of money during the accounting period but could not be required to be paid under the terms of the instrument by which payment was secured for a specific and subsequent date. The necessary calculation was made by ascertaining the amount of interest paid during the year and then deducting from it an amount estimated to have accrued by the end of the previous year, so that this element was removed from the current year's income. To the remainder from this subtraction the company added any interest which had accrued and was not yet due up until October 31, 1964, and the sum of this addition represented the total income which had accrued during the year. Clothing this formula with figures, from the total amount of interest payments received in cash during 1964 of \$4,684,862 there was deducted that portion of these payments applicable to interest accrued in 1963, leaving a remainder of \$3,313,781. To this was added the total amount of interest accrued but not paid on October 31, 1964 in the amount of \$1,859,132, with the result that income on an accrual basis for 1964 was recorded as \$5,172,913. The amount of interest which had accrued and was not paid up to October 31, 1963 was added to the company's reserves. In consequence the profit in 1964 was substantially increased over what it would have been had the treatment of income remained on a cash basis, owing chiefly to the fact that the mortgage portfolio at the end of 1964 was substantially larger than at the end of 1963, and the accrual of interest at October 31, 1964 was greater than that at October 31, 1963. In addition to the increase in the published profit of the company there was also an increase in the reserves because of the addition to them of the interest accrued at the previous year-end.

No objection can be taken to the method of this calculation, nor to the change of accounting principle involved. A serious question, however, arises about the adequacy of the disclosure to shareholders and the

public and its effect on the company's published profits and reserves. In the annual report of British Mortgage & Trust Company for 1964 the address of the president, Wilfrid P. Gregory, to the shareholders at the annual meeting was reproduced and deals as follows with this important change:¹

"You will note in the statement of Undivided Profits, the large amount of \$800,000.00 transferred to the General Reserve Fund. This becomes part of the capital of the Company and is important in many ratios which affect the amount of business we can do. This increase is largely the result of a change in our accounting practice by which we now compute interest on an accrual basis instead of on a cash basis. The result is that the adjustment of prior years' earnings after allowance for income taxes thereon adds to our Company assets the sum of \$744,971.00. We had always handled interest owing to the public on an accrual basis but our income had been calculated only on a cash basis. This latter method made good sense when the Company was smaller and when it did not have large year-to-year increases in assets. It also saved the necessity of the complicated calculation of accrued interest, which we now do by computer. It was also a conservative method of accounting in the Depression when it was started and resulted in the creation of additional reserves. Now we have several other types of reserves and it is not necessary from that point of view. In addition, the fact that we were charging ourselves large sums for accrued interest on new investment funds in the hands of the public and were not getting benefit of the accrued interest from our use of those funds served to distort the financial picture. The result of the change will be that your management will be able to get more frequent financial statements accurately depicting the progress of the Company. This information will be passed on to the shareholders in the form of quarterly statements."

Elsewhere in the president's address appears the sentence:

"The capital of the Company has increased by very close to \$1,000,000.00 mainly as a result of the change in accounting practice."

The only other reference made to the change of accounting was in note 2 to the 1964 balance sheet which read:

"In the fiscal year 1964, the Company changed its accounting for income from a cash to an accrual basis. Certain asset accounts (bonds, short term notes and mortgages) as at October 31, 1964 include accrued interest which was not in the comparable 1963 accounts."

Nowhere in the notes to the balance sheet or the auditors' report or the president's address is there any disclosure of the effect of the change in accounting on the earnings of the company. Nevertheless it was profound

¹Exhibit 4255.

BRITISH MORTGAGE & TRUST

and was expressed by Mr. Moreton as follows, in relation to the gross income from interest in the fiscal year of 1964:²

Interest received on a cash basis	\$4,684,862
Deduct:	
Interest accrued at October 31, 1963	1,371,081
	<u>\$3,313,781</u>
Add:	
Interest accrued at October 31, 1964	1,859,132
Interest income on accrual basis	<u>\$5,172,913</u>
Amount 1964 income on accrual basis is greater than it would have been on a cash basis	\$ 488,051

The following table shows British Mortgage & Trust's statement of undivided profits as published for 1964, re-stated to show the effect of the change in accounting for interest income. The column on the left shows the figures as reported and that on the right how the statement would have looked had the change not been made:

BRITISH MORTGAGE & TRUST COMPANY UNDIVIDED PROFITS — 1964

	<u>Accrual (New) Basis</u>	<u>Cash (Old) Basis</u>
Balance brought forward from the previous years	\$ 174,728	\$174,728
Add:		
Adjustment of prior years' earnings due to the change of accounting for income from a cash to an accrual basis (\$1,371,081) less allow- ance for income taxes thereon (\$626,110)	744,971	—
Adjusted balance brought for- ward	919,699	174,728
Add:		
Earnings for the year before income taxes	\$702,298	\$214,247
Less: Income taxes	<u>257,500</u>	(1) 2,460
	444,798	211,787
Gain on sale of company securities	332,199	332,199
Less: Transfer to reserve for real estate	(200,000)	(200,000)
Company securities written off	<u>(72,030)</u>	<u>(72,030)</u>
Net gain disclosed in financial statement	60,169	60,169
Premium on sale of capital stock	<u>73,180</u>	<u>73,180</u>
	<u>1,497,846</u>	<u>519,864</u>

²Exhibit 4257.

Deduct:

Settlement of 1958-1963 in-			
come tax	167,508		167,508
Dividends paid	<u>235,833</u>		<u>235,833</u>
		403,341	403,341
Balance before transfers to			
general reserve		1,094,505	116,523
Transfers to general reserve			
fund:			
Premium on capital stock ..	73,180		(2) 73,180
Other	<u>726,820</u>		<u>—</u>
		800,000	73,180
Balance available to be carried			
forward		<u>\$ 294,505</u>	<u>\$ 43,343</u>
1965 Dividend requirements at			
\$1.00 per share		<u>\$ 296,947</u>	<u>\$296,947</u>

Note 1: Amount actually paid by the company, which continued to compute income taxes on a cash basis.

Note 2: Assuming the company followed its established practice.

Dealing with the left hand column first, the figure \$174,728 shown as the balance brought forward from previous years is simply the reserve called "undivided profits", accumulated in the past. To this is added an adjustment of the previous year's earnings representing the total amount of interest accrued to October 31, 1963 in the amount of \$1,371,081, previously referred to, and added to the reserves of the company, less an allowance of \$626,110 for income taxes payable thereon for a net figure of \$744,971. This, added to the amount brought forward, yields a total of \$919,699. The figure of \$744,971 was disclosed in the annual report for 1964 as being an increase in the company's reserves arising out of the change of accounting; the figures lying behind the calculation do not appear. The allowance for income tax resulted from the assumption, made necessary by converting to an accrual basis in 1964, that the company had been on such a basis at the end of 1963 and had paid income tax on the \$1,371,081 added to its reserves; although the company never did report income for taxation purposes on an accrual basis, eventually his tax would have to be paid and was provided for in the company's accounts as a liability. Earnings for the year before tax are shown as \$702,298 on which provision was made for income taxes in the amount of \$257,500, leaving a net amount of \$444,798. On a cash basis the company earned \$214,247 and actually paid \$2,460 in tax. Then it added its gain from the sale of its securities which was not taxable in the sum of \$332,119, out of which \$200,000 was transferred to a reserve allocated to real estate held for sale, and \$72,030 to reduce the value at which company securities were held, for a net gain of \$60,169. To this was added the amount received on sales from its own stock in excess of par value of \$73,180 for total undivided profits of \$1,497,846. Deducted

from this was the amount required to settle an income tax assessment relating to the years 1958 to 1963 of \$167,508, and dividends were paid in the amount of \$235,833, leaving a balance before transfer to general reserve of \$1,094,505. These transfers, including the premium on the sale of capital stock, amounted in all to \$800,000, leaving a balance available to be carried forward of \$294,505, slightly less than the 1965 dividend requirement fixed at \$1 per share in the amount of \$296,947.

Since the additions and deductions referred to are the same on an accrual as on a cash basis and appear in both columns, British Mortgage & Trust would have had on a cash basis only \$116,523 before transfers to general reserve, which would in any event have been only the premium on the sale of capital stock, this being the established practice, leaving a balance to be carried forward of \$43,343. Therefore if the company had disclosed to its shareholders the effect of the change of accounting on the calculation of undivided profits, it is clear that, on a basis consistent with that adopted for the previous year, they would have decreased by \$131,385 in the course of the year under review.

The effect on the equity of the company of this change in accounting for interest income is shown as follows:

	<i>October 31, 1963</i>		<i>October 31, 1964</i>	
	<i>Cash Basis</i>	<i>Accrual Basis</i>	<i>Cash Basis</i>	<i>Accrual Basis</i>
Capital Stock	1,445,715	1,445,715	1,484,735	1,484,735
General Reserve	2,700,000	2,700,000	2,773,180	3,500,000
Profit & Loss	174,727	919,699	43,343	294,505
Total Equity ..	<u>\$4,320,442</u>	<u>\$5,065,414</u>	<u>\$4,301,258</u>	<u>\$5,279,240</u>

It will be observed that, had there been no change in the basis of accounting, the total equity available to shareholders would have been lower at October 31, 1964 than at the previous year-end, notwithstanding the sale of additional treasury shares during 1964. On the other hand, if British Mortgage & Trust had accounted on a accrual basis in 1963, as it did in 1964, then the equity would have risen by a sum in the order of \$214,000 because the increase in the size of the mortgage portfolio provided more interest to accrue in the 1964 period.

It has been seen that the only explanation contained in the financial statement sent to the shareholders consisted of note 2 to the balance sheet the words of which have already been quoted. The illusion of increased profitability was heightened by the 1964 figures being accompanied by the comparative figures for 1963. These were contained in the original audited statement sent to the company³ and therefore were not simply introduced to embellish the statement for the shareholders. The report

³Exhibit 4635.

contains the familiar words provided for in section 68(2) of the Loan and Trust Corporations Act, "in our opinion the accompanying balance sheet presents fairly the financial position of the company as at October 31, 1964", with no reference to any change in accounting. It was Mr. Moreton's view that, in accordance with normal accounting practice, the note to the balance sheet should have included a reference to the specific effect of the change of accounting particularly on earnings, perhaps in the following terms:

"In the fiscal year 1964 the company changed its accounting for income from a cash to an accrual basis. Had the cash basis been used in 1964, earnings for the year would have been \$233,000 less than shown in the statement of undivided profits."

Then the auditors' opinion could have been expressed as follows:

"In our opinion the accompanying balance sheet and statement of profit and loss and undivided profits present fairly the financial position of the company as at October 31, 1964, and the results of its operations for the year ended on that date in accordance with generally accepted accounting principles applied on a basis consistent with that of the previous year, except for the change in accounting for income from a cash to an accrual basis, as set out in Note 2."

In the absence of these precautions, or of any explanation of the effect on earnings in the president's address, anyone reading the published balance sheet and the statement of undivided profits set out in the annual report would conclude that British Mortgage & Trust was more profitable during 1964 than it had been in 1963, whereas adjusted figures would have shown that the opposite was true. In fact the company did not during 1964 make enough money to meet the dividend of \$1 per share to be paid quarterly thereafter, although the chairman of the board concluded his own address to the shareholders by saying that "it is now my privilege to state that your stock has been placed on a \$1 annual dividend basis".

Since the shareholders and other members of the public had evidently no opportunity of learning, much less understanding, what had transpired, it is important to ascertain who had. Wilfrid Gregory made a practice, as managing director, of making an annual confidential report to the board of directors as well as intermittently in the course of the year. The report dealing specifically with financial operations for the year ended October 31, 1964 was dated November 17;⁴ thus, a month before the annual meeting of shareholders, he explained the change in the accounting system to the directors in the following words:

"After consultation with our auditors, it was felt advisable to make a major change in one of our accounting procedures; i.e., from a cash

basis to an accrual basis of income. I have mentioned to the Board previously the difficulty of knowing the degree of profitability of the Company when we were operating on a cash basis for income. This latter method made good sense when the Company was smaller and when it did not have large year to year increases in assets. It also saved the necessity of the complicated calculation of accrued interest, which we now do by computer. It was also a conservative method of accounting in the depression, and created another hidden reserve. Now we have other types of reserves and it is not as necessary from that point of view. In addition, the fact that we were charging ourselves large sums for accrued interest on new investment funds in the hands of the public and were not getting the benefit of the accrued interest from our use of those funds, served to distort the financial picture. The result of the change will be that Management and the Board can get more frequent financial statements accurately depicting the progress of the Company. In addition, I feel it would be wise to present quarterly statements to the shareholders, now that we will be in a position to do so. I trust that the Board will approve this important revision.

What this change means to our capital structure, is shown in the Balance Sheet. Even after paying taxes on capitalizing accrued income, the sum of \$744,971 is added to the amount of our capital. This increased capital is of real assistance to us because many ratios of doing business depend on the total amounts of capital and reserves. Shortly, I expect that our permissible public funds will be limited to, probably, fifteen times capital and reserves. It is most important to our profitability that that base figure keeps increasing. It obviates the necessity of raising additional capital with its effect of diluting the equity."

There is no reference here, as will be observed, to the effect of the change of accounting on the reported earnings of the company during 1964, but later in the report he said:

"It is obvious that our operating margin continues to drop. This makes it harder and harder each year to maintain our earnings. It is only the increased volume of business which has enabled us to do so. I feel that this trend is going to continue. It is not limited to the financial industry. . . . You have the audited financial statement for the year which should be read in conjunction with this report. Our net income after taxes rose from \$359,528 to \$444,798."

He concluded:

"We have been paying dividends at the rate of 20¢ a share. With these increased earnings of \$1.49 per share and with the prospect of further improvements next year I feel that we are justified in going on a quarterly basis of 25¢ per share. With our ample reserves, there is no reason why the shareholders should not receive a reasonably high percentage of profits in dividends. Therefore, I recommend that this Company pay a regular dividend of 25c per share, payable on January 4th, 1965, to shareholders of record on December 11th, 1964."

Knowledge of Management and the Auditors

Nothing in the managing director's report on this occasion revealed to the directors the extent to which their company had indeed been less profitable in 1964 than in 1963, which could hardly have been expected to warrant an increase in the prevailing dividend rate of 80 cents per share per annum; on the contrary, it contained much to convey an opposite and false impression. Management itself, at least in the persons of Wilfrid Gregory who was treasurer of the company as well as president, and James R. Anderson, C.A., appointed comptroller in 1962, could not have deceived itself since income was still reported on a cash basis for income tax purposes, and for the year ended October 31, 1964 British Mortgage & Trust reported to the Department of National Revenue a taxable income of \$17,291.55, compared to one of \$204,382.84 for the previous year.¹ The two auditors were also in possession of the facts, although no correspondence between them and the company specifically referring to them has been found. However, Messrs. Black and Monteith both gave evidence to the Commission on May 17, 1967.² Black, who had been active in the audit for some thirty years, said that prior to 1957 W. H. Gregory had insisted on seeing the auditors whenever they visited Stratford and had always appeared to have an intimate and up-to-date knowledge of the company's operations. After 1957, when Wilfrid Gregory was managing director and was the appropriate person to have these discussions with the auditors, he was frequently away or otherwise unavailable. It had been the practice for the accounting firms represented by the two auditors of the company to alternate in the conduct of the annual audit, and, after 1961 when a "continuous" or monthly audit had been instituted, to conduct it in alternate months. Monthly statements as such were not produced, but each month a different aspect of the company's business would be examined in detail so that over the year all of them would have received close scrutiny. At the end of the financial year there would be a discussion between the auditors and the managing director and members of his staff in connection with the financial statement. Such a discussion occurred in 1964 between Black and Meldrum and Wilfrid Gregory and James R. Anderson; it concerned the nature of the note which the auditors insisted should be made to the balance sheet with an appropriate reference in the statement of undivided profits and which the company's representatives were anxious to dispense with altogether. Since Wilfrid Gregory testified some three weeks earlier on April 27, 1967, his account of it should be referred to first. Before

¹Exhibits 4269 and 4261.
²Evidence Volume 122.

approaching the subject of its nature Mr. Shepherd inquired about the change of accounting.³

"MR. SHEPHERD: Mr. Gregory, I can appreciate that the question that I am about to put to you may perhaps more fairly be put to the accountants concerned, but I would like to get your views.

There is evidence that up to 31st October, 1963, this company pursued an extremely conservative method of accounting in that it accrued interest on its liabilities, but it did not accrue interest on its assets, is that correct?

A. That is correct.

Q. And with effect from the year ending 31st October, 1964, although I appreciate that arrangements would have to begin to be made prior to that time, the company decided to change to a more liberal method of accounting and a method of accounting more commonly used among the industry and this is one where both interest on payables and interest on receivables are both accrued. Is that correct?

A. That is correct.

Q. So, the company made a change in its method of accounting and the accountants certified the company's balance sheet and on that balance sheet certified by the company, by the auditors, there were the figures for 1963 and the figures for 1964. Is that correct?

A. That is correct.

Q. Now, to narrow the issue in order to save time, let me make it plain that I am not directing any question at all to the desirability or the propriety or the wisdom of making the change of accounting.

My question to you and perhaps it could be more fairly put in detail to the auditors, is; what discussion if any, was had with the auditors as to whether this note without further reference by them in their auditors' report was (sufficient). This note is 'In the fiscal year 1964 the company changed its accounting for income from a cash to an accrual basis. Certain asset accounts (bonds, short term notes and mortgages) as at October 31st, 1964, include accrued interest which was not in the comparable 1963 accounts.' Have I read that correctly?

A. Yes.

Q. Now, the evidence is that if the auditors on this statement, or if the company on this statement, certified by the auditors had set out the 1963 figures on the same basis as 1964, or had otherwise expanded the note to show that the figure for undivided profits was not comparable as between one year and the other, it would have appeared that on the old basis of accounting, the company would not have been as profitable.

What discussions, if any, were had with the auditors about the fullness of the note or were there any?

³Evidence Volume 116, pp. 15930-5.

A. Yes sir, there were, and I refresh my mind on this after it was raised by talking to the comptroller who was in charge of accounting.

THE COMMISSIONER: Who was that?

A. Mr. James R. Anderson, comptroller of Victoria and Grey.

THE COMMISSIONER: Yes.

THE WITNESS: And he told me that this had been discussed with him by the auditors as part of their preparation or reporting as to the balance sheet or financial statement and one of them had raised the question of this.

MR. SHEPHERD: Do you recall which one it was?

A. Well, he said, Mr. Black, I believe.

Q. Yes?

A. And that Mr. Monteith and himself thought that by doing this it would distort the situation. It would give people undue alarm, because of the facts that we were growing so quickly and I think we were up 45,000,000 in assets in two years, so you can understand how this—we had been understating our earnings and as you said, there is nothing wrong with changing. We had to change it to be reasonable and accurate. It is just as bad understating as it is overstating. So, in any event, they thought that to go down in this year after two, we had written off the openings of all our Toronto branches—four Toronto branches, those expenses and then to go up the next year with the very bad—give a bad impression—not impression as much as the wrong impression, and they decided not.

Now, they came up and presented the results to me and mentioned this and I agreed with them that it would be—it would not be—and that was the end of that. It wasn't discussed at any great length and I—and Mr. Black, I am told, went back and discussed this with his own firm, and they agreed then with the other position that it would be wrong, because as you can see—and if we had done that in '64 by whatever comparable basis it was and then in '65, we would have been away up again to some—well, our earnings would have been instead of 45 in '64, '65 earnings would have been around \$600,000 and if we had gone down to two hundred and something in '64 from 300 down to 2, in '64 and jump up in '65 to 50 or 600,000 dollars, it just would have looked like the dickens, and this is why finally they decided in favour as I understood it, and why I agreed at any rate, that it would have distorted the picture by showing an apparent drop and a drop because we hadn't taken into account our earnings.

Q. And do I understand that the two auditors actually did consciously advert to the question of whether there should be disclosure, that the earnings on the same basis as had been used in the previous year had declined and decided that it was not desirable so to do and told you that that was their view of the matter. Is that correct? With which you agree?

A. I know what they told me and that is what they told me. Now, this is hearsay evidence as to what Mr. Anderson told me. Their discussion was . . .

Q. I meant only to refer to their discussions with you. Is what I have said a fair summary of what they did and told you?

A. That is a fair summary, sir, and may I say, certainly that it shocked me when this question was raised, because we have always tried to show as much as we can and one of the reasons we changed over was so I could go to quarterly statements which wasn't, and in my statement to the directors, I had a whole page on this, and in my statement to the shareholders, I took a whole column on the changeover and the fact that they were—we were now accounting an accrued interest on our income. Anybody who could read these things would see we must have had more money from these things if we were accounting accrued interest this year and didn't account it last year."

Black, after some preliminary difficulty in defining terms, dealt with this discussion and the specific nature of note 2 to the balance sheet:⁴

"Q. Would you please try again and tell me what you said to the company about the adequacy of that note?

A. We felt that that note, in accordance with what we understood to be the general practice of accountants, should contain a reference to what effect this change in accounting would have on the figures submitted in the statement, which would include the balance sheet and the earnings statement.

Q. Yes.

A. Even though we are not required to report on the earnings statement.

Q. Yes?

A. We did not have the actual data to report the difference in the earnings statements on an accrual basis.

Q. No.

A. We could have done it on a cash basis; we could have made the comparison on a cash basis.

Q. You could have said: If 1964 had been done on the same basis of accounting as 1963 the result would have been so and so?

A. Yes, the result would have been so and so, but I don't think that would have been a wise thing to have done, as a matter of judgment.

Q. Why do you think it would have been unwise to assert that?

A. Well, I think you get a misleading general figure out of it.

Q. Misleading in what sense, Mr. Black?

A. In the sense that they might think—the result, I presume, without actually going into it, would be a lesser figure than the year before.

⁴Evidence Volume 122, pp. 16476-82.

Q. Yes, substantially so.

A. The company might think, or the shareholder might think, or the general public might think that the company was actually in a worse position than it really was.

Q. Was that consideration discussed with the company?

A. I don't think so, Mr. Shepherd, no.

Q. Mr. Gregory said that he had an interview with the auditors on this point as well. Do you recall that?

A. That I don't recall. I would have thought that the whole discussion was with Mr. Anderson, and that he took the compromise wording to Mr. Gregory and said, 'Yes, that is it.' But if Mr. Gregory says he had a discussion, maybe he did.

Q. Would this then be a year in which, at the year-end, you did not actually have a meeting with Mr. Gregory, but rather you had a meeting with Mr. Anderson?

A. No. We would still have our meeting with Mr. Gregory. That was the policy that we had. Finally we discussed it, but this discussion we are talking about now on the question of whether to put this wording in or not would be with Mr. Anderson, before the draft was finally completed, and after the draft was completed, is when we would discuss it with Mr. Gregory.

Q. You said something about the shareholders being able to ask for more information with respect to the effect on earnings, for example, if they wanted to. Was that possibility put forward by anybody? Did anybody say: 'Well, if the shareholders want more information, let them ask at the meeting', or words to that effect?

A. I cannot say. It could have been. I don't know.

Q. Can you assist us any more than you have on that particular note?

A. I don't think so, Mr. Shepherd. As I say, my recollection is that we had quite a serious discussion on it, and this wording that we used was the minimum wording. We insisted that it go on the statement of undivided profits as a warning to look to see what effect it might have on the other.

Q. Do you now consider that fuller disclosure should have been made in the note with the advantage of hindsight?

A. Well yes, probably so, but again this would require quite a bit of expansion, to put the complete story across without getting a distorted view of it, in that the figures are not only just the one year, but there was an accumulation that was being picked up in this particular year, and if you quoted the accrued interest, for example, as it says here, say just for the sake of argument at a million and a half, which presumably it was earning there, they might think that there was a million and a half earned in the prior year that actually was not in the prior year; it was the accumulation of prior years.

THE COMMISSIONER: Dealing with your remark that the public might have got an unnecessarily alarming picture of the progress of the company if the note had been expanded, did you not think if the whole story had been told in the note, or some addendum to the report, the company could have made a good case for it?

A. Yes, I do. I agree.

Q. But the difficulty is, of course, no attempt was made to make the case?

A. Yes.

Q. So, the public had no opportunity of making what is the general test of what the progress of the company had been on an analysis based on principles consistent with the analysis made of the previous year of operation?

A. Yes, but the previous year of operations is not on the same basis as the current year. That is why you would have to, in my opinion, would have to have a very comprehensive note to cover the whole thing. I agree it would have been advisable to have that comprehensive note, if not on the balance sheet itself, somewhere attached to it.

THE COMMISSIONER: Yes.

MR. SHEPHERD: Would the note on the balance sheet not simply have been changed with the addition of words generally to the effect that had the company been on the same basis of accounting in 1964 as it was in 1963, the effect on undivided profits would have been to reduce them by \$200,000, or whatever the sum is?

A. I don't think you could make it that brief either, Mr. Shepherd, I think you would have to go into more detail than that.

Q. Then, surely, the only explanation that the company could advance, which was a valid explanation for the decline in profit, was that the company had been expanding on a greatly accelerated rate and had written off all the cost of branch expansion in one year?

A. Yes.

Q. And it would have been proper to deal with that, I suggest to you, in the president's report, he could have explained it?

A. Yes, that is right.

Q. But the note to the balance sheet could have been quite simple, and then could have been accompanied by a detailed statement by the president?

A. Yes, I agree it could be."

Although by 1964 A. B. Monteith's partner, J. A. Meldrum, had taken over the actual auditing work, the former did attend the annual meetings with the president of British Mortgage & Trust and his senior officers to present the draft financial statements. His evidence on these points,

given to the Commission on the same day in response to Mr. Shepherd's questions, was as follows:⁵

"Q. Turning now to the 1964 annual statement, Mr. Monteith, were you present when I put, at some length to Mr. Black, . . . ?

A. Yes, I was.

Q. . . . the fact that the note on the company's statement does not make reference to the effect on earnings and that the two years, 1963 and 1964, are shown in comparative columns although calculated on a different basis?

A. Yes.

Q. Were you yourself present at any meetings at which the appropriate method of reporting that change of accounting was discussed?

A. No I wasn't present.

Q. Have you had a discussion with Mr. Meldrum so you could inform yourself as best you may on what discussions were held?

A. Yes.

Q. What did you understand?

A. Well, I understood first of all—first of all, of course, that we insisted there must be some mention made of this change because it was material. I understood that the company were not anxious to have a lot of detail given in this regard. I also understand that there was some suggestion, I believe by Mr. Anderson of the company, that we might adjust the '63 figures, to put them in the same basis. Now, this could have been done as far as the balance sheet was concerned but it could not have been done as far as the statement of earnings was concerned because we didn't have the accrued interest total for January the 1st, 1963.

Q. Yes . . .

A. And it didn't seem to be sensible to do it in one place and not in another and finally their discussions led to the note which does appear on the statement and was agreed as the minimum and I was called, I recall now, by either Mr. Meldrum or Mr. Black and dropped into the company office to look it over and this was agreed to complete the statement on this basis.

Q. And was that agreement had with Mr. Anderson, the comptroller?

A. Not as far as I was concerned. They had more or less, if I agreed that the note was sufficient or adequate then apparently it was agreeable to the company.

Q. I see. Mr. Anderson was not present at the meeting that you were?

A. No he was not.

Q. Were you able to learn from Mr. Meldrum what reason the company advanced for originally not wanting a reference to the change of

⁵Evidence Volume 122, pp. 16496-500.

accounting and then thereafter having views which differed to some degree from your own as to what would be appropriate to do?

A. Well, I gathered from, as well as he could remember, that they felt it would not give a true picture of the 1964 operations.

Q. It would have been practical if it were desirable to show in the note what the effect on earnings in 1964 would have been on a cash basis, would it not?

A. It would have been possible, yes.

Q. Can you say whether that course was contemplated?

A. I don't—not to my knowledge.

Q. Would you have some hesitation about showing 1963 figures which you had already audited and on which you had already given an opinion on one basis; would you have had any hesitation in changing those around for comparative purposes to some different basis of accounting and setting them out in 1964 . . . ?

A. I would have had, sir.

Q. Would you agree that if it was to be done at all the least objectionable course from the viewpoint of the accountants would have been to make the reference in the note to the result had 1964 been on a cash basis?

A. That could have been done, yes.

Q. Was any thought given to the possibility of not including 1963 figures on the statement at all?

A. I believe so.

Q. For comparative purposes?

A. I believe so.

Q. Can you assist us as to how they got on there? Was it the company's desire?

A. I don't know whether that is true or not."

From these accounts the position adopted by the management of British Mortgage & Trust Company—at this juncture the president and managing director, Wilfrid P. Gregory and the comptroller James R. Anderson—clearly emerges as one of unwillingness to make even the minimum disclosure that the company's auditors regarded as essential. This was little enough, as it turned out, and must be judged to have been much less than the situation required. Although the position of auditors faced with a disagreement with the management of a client is an unenviable one, it must be faced resolutely and the opinion contained in their certificate qualified to reveal the full extent of the anomaly about which they think the shareholders should be informed. In this case they succeeded, as a compromise, in persuading the company's management to attach a note to the balance sheet and a corresponding reference in the

statement of undivided profits which were effective in concealing, rather than elucidating a matter of vital concern to the shareholders and to any members of the public who were interested in its progress—a decline in profitability which must have raised serious doubts of the competence of management had it been known, particularly in view of the decision to increase the dividend on the company's shares which the directors were persuaded to authorize. The auditors departed, I find, from the standard of disclosure which the generally accepted principles of their profession required them to observe, but management, for the actions of which Wilfrid Gregory must in this case alone be held responsible, was prepared to conceal absolutely the material facts of the company's situation and was with difficulty induced to offer the merest clue as to what they actually were. This was more than an error of judgment: not being inadvertent, it was morally obtuse.

The British Mortgage Profile

A return must be made from this considerable digression to further examination of Table 60 containing the comparative balance sheets of British Mortgage & Trust over the period 1957 to June 30, 1965. The item "Estates, Trusts and Agencies", shown separately from other assets, refers to those under the company's administration through the operation of either wills, trusts or contracts establishing agencies. At the beginning of the period these amounted to \$1,098,710 and by October 31, 1964 had grown to \$4,995,159. Income derived from this administration as set out on Table 61, the comparative statement of revenue and expenditure and undivided profits, was reported as \$11,940 at the end of 1957 and \$34,020 for 1964; in 1957 this amounted to .91% of the company's total income and in 1964 to .5%. Nothing more clearly illustrates than these figures what kind of a company it was. For 1964 the average for the trust company industry in Ontario showed some 53% of total revenue attributable to estates, trusts and agencies. In 1964 British Mortgage & Trust stood tenth out of the 31 trust companies reporting for the previous year to the Registrar on the size of their assets, excluding estates, trusts and agencies, but only twenty-second in respect of this category. A number of charts were offered in evidence and show, among other things, that British Mortgage & Trust operated in a manner more closely corresponding to the average loan company than the average trust company. These may be introduced by an examination of Table 62,¹ a graph showing the percentage growth of assets of British Mortgage & Trust in comparison with the average for loan companies and the average for trust companies during the period between 1959 and 1964. The general correspondence between the curve of British Mortgage & Trust and that of the average for loan companies is displayed by the

¹Exhibit 4274.

clearly marked increase in the mortgage investment which occurred during these years and was characteristic of the loan company industry. Generally speaking, the Loan and Trust Corporations Act contemplates a loan company as one which borrows money by receiving deposits on terms whereby the depositor is a creditor and by selling debentures which are secured by a charge on all the assets of the company, equal in priority to the charge of the depositor but not specifically secured; these funds are lent on mortgages and other securities in conformity with the provisions of the Act. The trust company, on the other hand, is a trustee for the depositor in respect of the funds which are deposited with it and also for those against which it issues guaranteed investment certificates, the distinction being between deposits payable on demand and payable on notice or after a fixed term. Both types of deposit, according to sections 80 and 82, must be matched by securities, or cash and securities, "ear-marked and definitely set aside", equal to their full aggregate amount for purposes of repayment as required, and a provincial trust company is specifically prohibited from borrowing money by taking deposits (section 79) or by issuing debentures (section 81). The principal departure from its rôle as trustee in these cases, as provided by the Act, is that it can retain any excess of income derived from investing these funds over what it is obliged to pay the depositor or guaranteed investor by way of interest at the rates agreed upon. British Mortgage & Trust resembled a trust company in the appearance of the liability side of its balance sheet, in that this included deposits as such and those liabilities represented by the issue of guaranteed investment certificates, but the assets side, and its operating statement as well, continued to resemble those of a loan company, in that a large proportion of its assets was loans on mortgages and its estates, trusts and agencies funds were unnaturally small.

A comparison between the assets of British Mortgage & Trust during the same five-year period with the assets of the average trust company registered in Ontario is shown in chart form as Table 63.² In 1959 the average trust company had approximately 40% of its assets invested in mortgages, while British Mortgage & Trust had 80% so invested; by 1964 the trust company average had risen to some 50% and the British Mortgage & Trust percentage had declined to about 72%, but the gap was still wide. In the same year the average trust company had close to 45% of its total assets invested in bonds; in the case of British Mortgage & Trust the proportion was less than 10%. Again the investment in stocks of the average trust company in 1959 was about 7¾% of its assets, including those held as collateral security for loans, a figure which had decreased by 1964 to a little more than 5%, while British Mortgage & Trust in 1959 had a total investment of over 8½% of its assets in stocks, a proportion which remained almost steady throughout the period.

²Exhibit 4275.

The "Other Assets" of British Mortgage & Trust constituted a significantly higher percentage of the whole than that of the average trust company; this was largely due to its investment in new premises. As opposed to these comparisons Table 64,³ which sets side by side the composition of the British Mortgage & Trust assets with the average for the loan company industry, shows a much closer resemblance.

The liability side of the British Mortgage & Trust balance sheet was similarly compared with that of the average in the loan company industry on Table 65⁴ and the average for trust companies on Table 66⁵ over the same five-year period. It is apparent from the former that the company had lower deposits than the average for loan companies but somewhat higher guaranteed investments; its capital stock and reserves were notably below average, particularly towards 1964. But again the picture presented by Table 65 makes British Mortgage & Trust look more like the average loan company if guaranteed investments are considered as analogous to debentures; there is a definite similarity in the level of deposits, and the principal difference between British Mortgage & Trust and the average in the loan company industry is that its capital and reserve were markedly below it. In 1959 the British Mortgage equity was about 8% of its total liabilities in comparison with a loan company average of about twice as much, and in 1964 it had dropped to about 7% as against almost 14% as the average proportion. Therefore the capital and reserve of British Mortgage & Trust were significantly lower than the average for both trust and loan companies, treated as a percentage of liabilities, and its capital was more readily susceptible to impairment. Guaranteed funds were significantly higher in their proportion to total liabilities than the average in either case.

Branch Office Development

Management was keenly conscious of the need to increase deposits and this led to a significant departure in its traditional policy by the opening of branch offices at a rapid rate between 1961 and 1964, when the process, as indicated by the managing director's reports, was considered to be at least temporarily complete in view of leaner times contemplated for the immediate future. The first branch office was opened in Brampton in 1961 and was followed in the same year by a new branch in Listowel. In 1962 branches at Hanover and Goderich became permanent and additional branches were opened in Port Credit, Newmarket and St. Marys, the last two being temporary quarters. In 1963 the company invaded the highly competitive but productive area of Metropolitan Toronto where its first branch was opened at 2200 Yonge Street, and additional branches were established in Richmond

³Exhibit 4276.

⁴Exhibit 4277.

⁵Exhibit 4278.

Hill to the north and Exeter in the far west. In the month of February 1964 alone five new branches were opened in Toronto. Details of the opening of these branch offices and the composition of the advisory boards which were recruited from the communities which they served, in accordance with growing trust company practice, are set out hereunder.¹

	<i>Temporary</i>	<i>Permanent</i>	<i>Branch Advisory Boards (year established)</i>
Brampton		Mar. 17/61	(61) A. G. Davis, E. Brownridge.
Hanover	Aug. 9/61	Oct. 26/62	(62) G. K. Crockford, J. M. Duffield, A. J. McNab.
Goderich	Sept. 5/61	Sept. 7/62	(62) J. M. Donnelly, E. B. Menzies. (64) J. K. Sully.
Listowel	—	Nov. 10/61	(61) D. D. Hay, R. W. Andrew, C. J. Benson, A. Malcolm, W. M. Pratt.
Newmarket	Sept. 17/62	June 4/64	(62) K. Stiver, C. T. Evans, A. M. Mills.
St. Marys	Sept. 17/62	Jan. 24/64	(64) Brig. J. S. H. Lind, E. B. Clysdale, J. W. Eedy.
Port Credit	—	Oct. 15/62	(62) J. C. Pallet, J. A. D. Gray, R. H. Watson.
Richmond Hill	Jan. 18/63	Sept. 10/64	(63) H. R. Button, S. P. Parker, J. E. Smith.
Exeter	June 14/63	Apr. 2/65	(63) E. Bell, R. L. Raymond, B. W. Tuckey.
Toronto:			(63) J. W. Cochrane, B. Luxenberg, C. P. Morgan, J. T. Weir. (64) H. R. Lawson, J. W. McCutcheon.
2200 Yonge St.		— June 27/63	
1520 Danforth Ave.		— Feb. 7/64	
1887 Eglinton Ave. W.		— Feb. 7/64	
2262 Bloor St. W.		— Feb. 14/64	
635 College St.		— Feb. 14/64	
4 King St. W.		— Feb. 25/64	

The effect of opening new branches on this scale and over a short period tended substantially to reduce the amount of the company's profit; in his confidential reports to the directors Wilfrid Gregory made numerous references to the branch office problem, referring to the expenses of establishing a branch written off in the year in which it was opened, the time required for a particular branch to reach a profitable stage, which might be as long as three years, and the effect of competition in the area in which a new branch had been installed which increased the costs of obtaining new business through the establishment of higher interest rates. The higher operating costs met with in Toronto was also a recurring theme. The company prepared statements of branch office profits and losses for the half-year ended April 30, 1965² and a summary of these

¹Exhibit 4279.

²Exhibit 4284.

indicates that he was perhaps too sanguine in expecting the "break-even" point to be reached in three years. Figures are given for fourteen branches as follows:

- (1) Brampton opened in March 1961; loss of \$1,498
- (2) Hanover opened October 1962; loss of \$8,954
- (3) Goderich opened September 1961; loss of \$11,516
- (4) Listowel opened November 1961; loss of \$2,720
- (5) Newmarket opened September 1962; loss of \$4,336
- (6) St. Marys opened September 1962; loss of \$2,536
- (7) Port Credit opened October 1962; profit of \$219
- (8) Richmond Hill opened January 1963; loss of \$7,818
- (9) 2200 Yonge Street, Toronto opened in the spring of 1963; profit of \$17,348
- (10) Exeter opened June 1963; loss of \$17,347
- (11) Bloor Street West, Toronto opened February 1964; loss of \$13,092
- (12) College Street, Toronto opened February 1964; loss of \$13,571
- (13) Danforth Avenue, Toronto opened February 1964; loss of \$13,577
- (14) Eglinton Avenue West, Toronto opened February 1964; loss of \$12,782

Thus only two branches showed a profit for the half-year ended April 30, 1965; 2200 Yonge Street, which was the first in Toronto, did substantial mortgage business and had held, as will be recalled, the \$1,200,000 deposit attributed to Lucayan Beach Hotel Company, and Port Credit, neither one of which was quite two years old. No statement was prepared of the profit or loss of a Toronto branch at 4 King Street West opened in February 1964, but this was an area supervisory office, presided over by A. V. Crate, and may not have lent itself to this type of analysis; nor had the Toronto mortgage office, operated by J. W. Paterson until 1955 and thereafter by L. W. Facey, which had been in existence in various rented premises since before the war, ever been considered a branch office in the company's published statements since it merely housed a real estate appraisal service in connection with mortgage loans. The net loss for six months for 14 branches reported on amounted to \$92,180.

Changes in Investment Policy

An examination of the annual reports to the Registrar for the year 1957 and onward shows a remarkable increase in the number of mortgage loans over \$50,000 all of which were required to be reported to

him.¹ In 1957 the company had 11 loans in this category, aggregating \$881,192 or 4.41% of the mortgage portfolio. By the end of 1958, or the second year of Wilfrid Gregory's stewardship, these had risen to the amount of \$3,177,992, represented by 22 mortgages, or a percentage increase in value over the previous year of 260.65%. By the year-end in 1964 there were 180 such mortgages, representing assets of \$39,472,056 or 52.83% of all the company's mortgage loans, with the average amount secured being upwards of \$200,000. It was in 1958 that loans on mortgages of vacant land, assembled for purposes of sub-division, first appear amounting to \$440,000, and these by 1964 had grown to \$1,830,000 or about 2½% of the total portfolio. There is, therefore, a noticeable trend towards more liberal lending during the seven years after a long period of conservative operation in the mortgage field under the management of W. H. Gregory, but it would be no more than fair to attribute a portion of this to increased costs and an increased money supply across the country. The comparative balance sheets of British Mortgage & Trust² show further a decline in the company's holdings of government and municipal bonds from 8.6% of the assets in 1957 to about 6.8% in 1964 and in corporation bonds of 2.9% to 1.3% for the same years. This is scarcely significant except for the fact that in 1964 the company held, in its corporation bond portfolio, \$120,300 worth of Aurora Leasing Corporation debentures, \$50,000 in Commodore Business Machine debentures and \$38,000 of those of N.G.K. Investments, and from time to time the investment in the securities of Commodore Business Machines was much higher. The annual Statements to the Registrar also required the listing of stocks held by the company and in 1957³ they represented about 6½% of the assets with a book value of \$2,011,000. The average investment in any one company, of which there were 53 in all, amounted to \$38,000, the highest being in the preferred shares of B.C. Telephone in the amount of \$260,000 representing 13% of the portfolio. In common shares the five companies, representing the largest positions held by British Mortgage & Trust in that year, were Dome Mines, Canada & Dominion Sugar, Traders Finance Corporation, Page Hersey Tubes and Dominion Oilcloth & Linoleum, amounting in all to an investment of \$389,300 or about 19½% of the total stocks.

These holdings constituted a fairly conservative policy of investment, but in 1964, although the proportion of stocks to total assets was not significantly changed, the book value was approximately \$7,200,000, the average investment being \$150,000 for a total of 48 issues. The highest sum invested in the shares of any one company was \$1,064,000 in the common and preference shares of Atlantic Acceptance Corporation, or

¹Exhibit 4285.

²Table 60.

³Exhibit 4286.

15% of the portfolio. Again, as far as common stocks are concerned, the five companies representing the largest holdings of British Mortgage & Trust, and the amounts invested, were Atlantic Acceptance \$535,000, Premier Trust Company \$481,000, Sterling Trust Company \$518,000, Traders Finance Corporation \$335,000, and Laurentide Acceptance Corporation \$301,000, for a total of \$2,170,000, or 30% of the portfolio. It will be noted that in 1957 investment in stocks covered a wide range of industry; in 1964 about 58% of their total was invested in the shares of trust and loan companies and acceptance finance companies.⁴ This was in accordance with the view of Wilfrid Gregory's confidential report to the directors for 1964 in which he sounded a warning note about the state of the stock market and said that the company's portfolio had been revised "to place us in more defensive securities which would hold up better during a period of recession, e.g. foods, and financial institutions".⁵

Summary of the Change in Direction

An attempt can be made here to summarize what the evidence, so far considered, about the operations and structure of British Mortgage & Trust Company, may fairly be said to indicate. In the early 1920's the company took advantage of the shift in public policy in Ontario which had, at the beginning of the century, set its face against the creation of any more trust companies but changed in the years after the First World War. In company with several other mortgage loan corporations, British Mortgage & Trust assumed the technical status of a trust company, but like others similarly situated in rural areas of the province it continued to look like a loan company and to carry on a loan company type of business. Thus it never developed its estates, trusts and agency business to an extent commensurate with its new status and it is reasonable to assume that, since novelties in business practice begin first in large urban communities and penetrate more slowly into the countryside, this type of business fell first into the hands of corporations doing business in the large cities, where the marketing of securities and the accumulation of fortunes derived from industry and commerce largely occur, and stayed there. So also, in an environment where deposits are more limited, it felt more keenly the competition of the chartered banks in attracting them. On the other hand, the lending of money on mortgages had been its life-blood since 1877, and this field, which until only recently was barred to the chartered banks, it was, like other rural trust and loan companies, still able to dominate. For a time after the Second World War it continued, under the management of W. H. Gregory, to do the type of business it had always done; with its conservative system of

⁴Exhibit 4288.

⁵Exhibit 4281.2.

accounting and its conservative management it was moderately profitable, and, like other trust companies, a byword for solidity. In 1957 there were 439 shareholders, largely concentrated in Stratford and its environs, and the company stood eleventh in the size of its assets out of 23 reporting them to the Registrar. Then the management of the company's affairs was taken over by Wilfrid P. Gregory, a lawyer with an established professional and political reputation, with no experience of the business of trust companies, but presumably under the guidance of his father who for a while retained the presidency but relinquished both control and responsibility to his son. Wilfrid Gregory made many changes and greatly expanded the scope of the company's operations. He was aware of the need to acquire larger deposits, not only to meet the competition of the chartered banks but to forestall the threat to the traditional business of British Mortgage & Trust represented by the contemplated amendments to the Bank Act by Parliament, permitting their entry into the field of mortgage loans. This led him to engage, with other trust companies, in the establishment of branches further and further afield and to obtain a greater volume of deposits with which investments profitable to the company might be made. Constantly in the forefront of his mind was the narrowing gap between the rates of interest which his company had to pay on deposits and guaranteed funds and the rates of interest which could be obtained by their investment, producing a general decline in profitability which could only be met by enlarging the company's assets. Since the great predominance of mortgage loans in proportion to the company's total assets was traditional and shared by other trust companies, similarly situated, like Victoria and Grey Trust Company, he also found it inescapable. By making larger loans and taking greater risks—a tendency which will be illustrated more fully later on—he tried to make this substantial area of the company's operations more profitable. The search for profits was pressed with particular vigour in the complementary field of investment in securities, and here it must be borne in mind that, although capital gains made in the investment and re-investment of funds for which the company was trustee were taxable as income on the assumption that this was its proper business, those made by the same employment of its own funds were not.

By 1964 British Mortgage & Trust had been largely transformed. Its assets had grown to over 300% of their value in 1957, a rate substantially higher than the average in the industry, and it stood tenth out of 31 trust companies reporting them. It had 15 branch offices and its shareholders had grown in number to 864, drawn from many municipalities outside the Stratford area. Its basis of accounting had been changed under circumstances which have been closely examined and in a manner which effectively concealed the fact that its operations were becoming

less profitable, if accounted for on a basis consistent with that prevailing in the years before 1964. Finally the investment of its own funds was by 1964 less diversified than at the beginning of the period, and concentrated not only in the securities of companies of a similar type, but to an increasing extent in those that were related. This process in particular must now be examined.

The Atlantic Complex

The extent to which the assets of British Mortgage & Trust Company were invested in securities of Atlantic Acceptance Corporation and related companies, such as Commodore Business Machines, Aurora Leasing Corporation, N.G.K. Investments, Western Heritage Properties, Mavety Film Delivery, London Lighthouse Investments, Associated Canadian Holdings, Trans Commercial Acceptance and individual borrowers connected with C. P. Morgan and his enterprises, and the trend of such investments over the years of Wilfrid Gregory's direction of its affairs, have been illustrated by three schedules the first of which is Table 67,¹ showing the gradual increase of the company's investment by purchase and the taking of collateral security in the shares and obligations of companies in the Atlantic complex in relation to all the securities held, Table 68,² on which the Atlantic investments are analysed by category, and Table 69,³ consisting of two pages which shows the security transactions involved in the Atlantic investment before and after October 31 on which the fiscal years ended. The first investment occurred in January of 1959 when British Mortgage & Trust bought the 5½ % preferred shares of Atlantic Acceptance, as has been seen. By October 31 of that year \$20,306 was invested in preferred shares and \$54,957 in the common shares. In addition, at that date the company had bought common shares of Analogue Controls for \$71,085 and warrants of Great Northern Capital Corporation for \$10,000, making a total investment of \$156,348. These holdings amounted to 2.3% of the total portfolio of all investments of company or guaranteed funds. It should be noted that Analogue Controls at this stage was not within the Atlantic orbit through the investment made by Commodore Business Machines in 1962, although Carman G. King, a friend of Wilfrid Gregory, was on the board of directors and a member of the firm which was promoting its stock. By June 30, 1965 this had risen to \$10,175,058, a figure which represented 33.3% of the portfolio, but it would be misleading to describe this as a steady rise in the scale of investment. In November of 1959, immediately following the end of the company's fiscal year, it made its

¹Exhibit 4289.

²Exhibit 4290.

³Exhibit 4291.

first purchase of notes of Atlantic Acceptance in the amount of \$250,000. By September 30, in 1960, this investment had reached a total of \$1,000,000. At the year-end, on October 31, these holdings had been reduced to \$500,000, although, with the acquisition of additional common shares and the selling of some preference shares, the gross investment in Atlantic securities amounted to \$626,240, a reduction on the total invested at the end of the previous month which was \$1,126,240. British Mortgage & Trust also bought part of the minority interest in Commodore Sales Acceptance, with the profitable results attendant on its eventual acquisition by Atlantic which have already been described,⁴ amounting to an investment of \$139,244. The investment in Analogue Controls, which had increased to \$97,620 at the end of September, was reduced in October to \$73,273, so that by October 31, 1960 the aggregate amount of British Mortgage & Trust money invested in the Atlantic companies was \$838,757.

Before proceeding further with an examination of the investments in the Atlantic complex and the way in which they fluctuated before and after the end of each fiscal year, at which time the holdings of British Mortgage & Trust had to be disclosed to the Registrar of Loan and Trust Corporations, it will be useful to look at Table 70⁵ which shows their growth and decline in graphic form. This should be examined in conjunction with Table 69. The explanatory legend includes a list of the companies comprising the "Atlantic Acceptance complex" and lists the companies treated as part of it, all of which have been referred to repeatedly throughout this report, except, perhaps, Western Heritage Properties Limited which was a wholly-owned subsidiary of Great Northern Capital Corporation, the company controlled by the Lambert partnership in New York, eventually owning a majority interest in Atlantic itself. The curves of the graph show total corporate investments and collateral loans of British Mortgage & Trust, its investment in the Atlantic complex and its investment in the securities of Atlantic Acceptance. Superimposed on these is a red line identified as "Limitation, section 142(1)(a) (iii)" which refers to the limits of investment imposed upon both loan and trust companies by that provision of the Loan and Trust Corporations Act which will be examined in more detail below.

No sooner had the critical date of October 31, 1960 been passed than \$1,300,000 was forthwith used by British Mortgage & Trust to purchase Atlantic Acceptance secured notes and another \$9,000 for preference shares, bringing the total investment to \$1,935,375 by the end of November. That this was not an isolated event can be seen by examining other fluctuations of this nature. On September 30, 1962 for

⁴Chapter V, p. 119.

⁵Exhibit 4292.

instance, investment in Atlantic shares and notes was over \$10,000,000; by October 31 it had been reduced to \$3,260,000. Then, by the end of November, it rose again to \$5,700,000, falling just short of \$3,000,000 in January and February of 1963. The scale of the investment rose and fell throughout 1963 and by the end of September amounted to \$4,053,000; then, at the end of October, which was the end of the company's financial year, it was reduced to \$2,100,000. Looking at the investment in the whole complex at the end of September, it will be seen that it amounted to approximately \$7,000,000, was reduced before the year-end to \$4,700,000 and rose again immediately thereafter to \$6,400,000. Again, in September 1964, investment in the complex stands at approximately \$9,300,000, having descended from well over \$10,000,000, but at October 31 it had been reduced to \$7,300,000. Immediately after the year-end it rose to something in excess of \$10,000,000 and by the end of April 1965 over \$14,500,000 had been invested. This was the highest level of investment by British Mortgage & Trust in the Atlantic complex and Wilfrid Gregory, in his evidence before the Commission, suggested it was at about this time that his confidence in C. P. Morgan and Jack Tramiel began to diminish. It has been seen that in his confidential report to the directors of his company, given on November 17, 1964, he expressed the view that the further expansion of the trust company should be deferred until the general state of business on the stock market in 1965 could be declared. He testified that on some unspecified occasion he communicated these cautious opinions to Morgan who had been non-committal; the accelerated pace of the expansion of Atlantic Acceptance in a period when he himself thought that British Mortgage & Trust should pause to conserve its strength made him uneasy, particularly about the large collateral loans which had been made to Morgan and his associates and which he was determined to call in. A factor which may have contributed to his opinion was the concern shown by the Registrar of Loan and Trust Corporations and his examiners at this juncture, in the course of correspondence which will be referred to later. In any event, by June 17, 1965, the date when Atlantic Acceptance was ordered into receivership, the total investment in the complex had been reduced to \$12,200,517. As already mentioned, by the end of that month it had been again reduced to something over \$10,000,000. At June 17 it was made up of \$5,374,000 invested in the securities of Atlantic itself which included a note for \$750,000, reported to the Registrar as an Atlantic note, but in reality, as already described, a note of Treasure Island Gardens Limited, made in favour of Atlantic and assigned by it to British Mortgage & Trust. The sum of \$2,050,585 had been invested in the shares and notes of Aurora Leasing Corporation, \$38,000 in the securities of N.G.K. Investments and \$269,000 in those

of Commodore Business Machines, the last figure not including large collateral loans made on the security of that company's shares. Other securities were those of Western Heritage Properties in the amount of \$500,000, Mavety Film Delivery \$80,000 and London Lighthouse Investments \$480,000, this last being again a note guaranteed by Atlantic but not secured under the trust deeds. The figure for collateral loans at June 17, 1965 given on Table 69 is \$3,907,960. Generally speaking, these were secured by the pledge of securities in the Atlantic complex, especially those of Commodore Business Machines.

Section 142 of The Loan and Trust Corporations Act

At April 30, 1965, that point in time when British Mortgage & Trust had the largest sum outstanding by way of investment, excluding mortgages and amounting to \$28,769,000, over 50% of this sum was invested in securities, or in loans made against securities of Atlantic Acceptance or the companies related to it. The greatest single factor contributing to the fluctuations which have been referred to, and graphically illustrated on Table 70, was the purchase and sale of short-term notes. The first investment in these appears in 1960 for an amount of \$500,000 and by June 30, 1965 it amounted to a commitment of \$10,800,000 of which by far the greater part was represented by the short-term notes of companies in the Atlantic complex. These fluctuations can only be explained by the provisions of section 142 of the Loan and Trust Corporations Act¹ which, as it still stood in 1964, read as follows:

"142.—(1) On and after the 14th day of April, 1925, no corporation shall,

- (a) except as to securities issued or guaranteed by the government of Canada or the government of any province of Canada or by any municipal corporation in Ontario,
 - (i) subject to subclause iii, invest in any one security an amount exceeding 15 per cent of its own paid in capital stock and reserve funds, or
 - (ii) make a total investment in any one company or bank maturing in more than one year, including the purchase of its stock or other securities and the lending to it on the security of its debentures, mortgages or other assets or any part thereof, of an amount exceeding 15 per cent of its own paid in capital stock and reserve funds, or
 - (iii) make an investment referred to in subclause ii maturing in one year or less in an amount that together with the amount invested to which subclause ii applies exceeds in the case of a registered loan corporation the aggregate of 20 per cent of its own paid in capital stock and

¹R.S.O. 1960 c. 222.

reserve funds and 5 per cent of moneys borrowed on debentures and by way of deposit under section 71 and, in the case of a registered trust company, the aggregate of 20 per cent of its own paid in capital stock and reserve funds and 5 per cent of moneys received as deposits and for guaranteed investment under sections 80 and 82:

- (b) make any investment the effect of which will be that the corporation will hold more than 20 per cent of the stock or more than 20 per cent of the debentures of any one corporation, company or bank.

(2) In the case of a trust company, subsection 1 applies only to the investment of its funds and of moneys received for guaranteed investment or as deposits under sections 82 and 80.

(3) This section does not apply to an investment in the paid up capital stock of a trust company having its head office in Ontario if the investment has been authorized by the Lieutenant Governor in Council. R.S.O. 1960, c. 222, s.142."

Since every word of a section of this type has operative effect, an attempt to paraphrase it is of doubtful value, but because of the difficulty of the section it must be made. Two things should be noticed as a preliminary: the limitation on investments and loans in subsection (1) does not apply to a loan or trust company's holdings of the bonds of Canada, or any province or any municipal corporation in Ontario, issued or guaranteed by them, or to an investment—it is not defined—in the capital stock of a trust company having its head office in Ontario, if this has been authorized by order-in-council. Then, by subsection (2) the limitations in the case of the trust company apply only to its company funds and guaranteed funds. Subject to these a trust company is prevented, in the case of an investment of any description in any one security, from committing a sum which is more than 15% of its own capital stock and reserve funds, or, in the case of any one company or bank, making a total investment (here defined as the purchase of its stock or other securities and the lending to it on the security of its debentures, mortgages or other assets or any part thereof) of more than the same proportion of its capital and reserves which matures, or is repayable in more than one year after the date of such investment. Then, in relation to the total investment in any one company or bank which matures in one year or less, added to such an investment maturing in more than one year, the aggregate amount must not exceed 20% of the trust company's capital stock and reserves plus 5% of its guaranteed funds, always providing that the purchase of any one security of any such company or bank must not exceed 15% of such capital stock and reserves. A calculation of the amounts which, from year to year, represented 15% and 20% of the capital stock and reserves of British Mortgage & Trust and 5% of its

guaranteed funds, together with the effect of the limitation as expressed in subsection (1)(a)(iii) in terms of dollars and cents from December 31, 1956 to October 31, 1964, may be found at Table 71.² Finally there is a calculation of the actual limitation imposed by section 142 (1)(a)(iii). The calculation of the aggregate capital stock and reserve funds was and is generally considered to require addition of the actual amount paid into the company's treasury for the issue and purchase of stock to the general reserves set up under section 89 of the Act which are free or unallocated, and to the "profit and loss account", which is the undivided profits not specifically transferred to a reserve, but none the less considered available as general reserves of the company. Then certain specific or allocated reserves have been added, the mortgage reserve, company stock reserve and the bonds reserve, which were set aside throughout the period, together with reserves for real estate held for investment and for real estate held for sale which were only allocated in the fiscal year 1964. About the inclusion of these allocated reserves something in parenthesis must be said.

"Capital and Reserves" Undefined

On October 31, 1964 the mortgage portfolio of British Mortgage & Trust amounted to \$76,439,377 against which was held a reserve of \$900,900, the maximum permitted under the Income Tax Act. Commonly accepted accounting practice provided that, if no individual mortgage required any reserve to be specifically set up against it, this would be classed as a free reserve, but to the extent that any mortgage required a specific allowance against loss it would not. The correspondence between the company and the Registrar¹ contains a letter, dated March 4, 1963,² written by H. W. Allan, an examiner on his staff, to W. P. Gregory setting out this position. In his own letter to Gregory written on April 2, 1965, and previously referred to,³ the Registrar, Mr. Cecil Richards, F.C.A., questioned the sufficiency of the mortgage reserve and pointed out that if some of the company's mortgages were not in a current position substantial specific reserves should be made against them. In his reply, dated April 20, 1965,⁴ Gregory assured Richards that his fears were unfounded and that none of the mortgages were in default. Although this statement must be critically examined hereafter, the Commission's accountants assumed that the statement of the president of the company was correct and, in calculating the amount of the reserves for the production of Table 71 and drawing conclusions from it, treated the whole of the \$900,900 as free and part of the general

²Exhibit 4293.

³Exhibit 2553.

⁴Exhibit 2553.1.

⁵Exhibit 2553.2.

⁶Exhibit 2553.3.

reserve. Here it should be noted that the Loan and Trust Corporations Act contained no definition of reserves nor drew any distinction between allocated and unallocated reserves or, in other and perhaps preferable terms used by accountants, reserves and allowances for loss. The Registrar had for many years been in the habit of making rules, with the tacit approval of the Trust Companies' Association, as a gloss upon the Act in those cases where it was silent, and, as will be seen later, when the extent of his knowledge of the affairs of British Mortgage & Trust falls to be considered, Wilfrid Gregory did not hesitate to assert his own opinion as a lawyer as to how the Act should be interpreted against that of the Registrar on some important questions. Then again, the reserve with respect to the real estate held for sale which had been acquired by foreclosure of mortgages in default, appearing first at October 31, 1964, amounted to \$200,000 against assets in this category of \$2,716,848. In its correspondence with the Registrar, British Mortgage & Trust admitted that \$82,500 of this should be allocated to a mortgage secured by property in St. Catharines, Ontario, known as the Lincoln-Church Shopping Plaza, but for the purpose of calculating the aggregate of capital and reserves the company was given the benefit of the doubt by the Commission's accountants and the whole \$200,000 was treated as a free reserve.

Breaches of the Limitation on Investments

Having established the basis on which the capital and reserves of British Mortgage & Trust had been calculated, and having conceded to the company the points which were at issue between its president and the Registrar by treating the allocated reserves as free, and therefore able to be included in the total upon which the limitations on trust company investments were to be calculated, it is permissible, by the use of Table 71 and the graph which is Table 70, to see to what extent the company observed the limitation imposed by section 142(1)(a)(iii). As mentioned above, this is illustrated on the graph by a red line showing, in relation to the other curves, what constituted 20% of capital and reserves plus 10% of deposits and guaranteed investments. It will be noted that the black curve representing investments in the securities of Atlantic Acceptance itself does not rise above the line of limitation until January of 1962, at which time the maximum investment of British Mortgage & Trust should have been \$3,200,000, but was in fact \$5,900,000; by September 30, 1962 it had increased to slightly over \$10,000,000 as compared with the same permitted maximum. During October of that year, at the end of which the company was required to report the extent of its investment to the Registrar, it was reduced to approximately \$3,260,000, rising again by the end of November to something in the order of \$5,700,000 which again constituted a breach of the limitation and this time came to

the attention of the auditors. Mr. Black, of Campbell, Lawless & Punchard, on November 22, 1962¹ wrote as follows:

"Dear Mr. Gregory:

As of November 19, 1962 the holdings in Atlantic Acceptance Corporation were recorded on the books as follows:

Short term notes	\$3,805,000
2nd Preferred 21,750 shares.....	522,000
1st Preferred 2,795 shares.....	49,000
Common 26,036 shares.....	324,000
	<hr/> \$4,700,000

In our opinion this would be a breach of section 142(1)iii. Subsection 142(1)b should not be overlooked in this connection although in our opinion, there is no breach thereof in connection with the stock."

No reply to this letter has been found and it seems to be the first one calling in question the propriety of the investment policy of British Mortgage & Trust. It was apparently effective, because in January 1963 the company began to dispose of its Atlantic Acceptance securities until in March its holdings were well below the limitation. Although in May and again in September this had been transgressed, the excess of permitted investment was comparatively trifling. In October over \$2,000,000 worth of the Atlantic investment was disposed of to bring it down to a little over that amount at the critical year-end date.

The requirement for a trust company to make the annual statement to the Registrar is contained in section 152 of the Loan and Trust Corporations Act; this provides that it should be prepared annually on the first day of January or within two months thereafter, according to a printed form containing a statement of the financial condition and affairs of the company, "up to the 31st day of December next preceding or to any day not more than two months prior thereto". The printed form referred to required a much fuller report than that which was, by custom, given to the shareholders and the public and considerable detail about transfer to and from reserves. It also contained the following statement to be signed by the two auditors of the company: "All transactions of the said company that have come within our notice have been within the powers of the said company." There was no specific requirement on the form provided for the auditors to report all breaches of the Act which had come to their notice, and from the evidence given to the Commission there has evidently been some sophistry in the attitude of auditors making this declaration, on the assumption that a company as a person has the power, if not the right, to act in breach of statute. This is a luxury clearly not afforded to a company created by or under a statute defining its powers.

¹Exhibit 4268.1.

To take a specific example of the type of breach referred to which appears to be more than accidental, between October 29 and October 31, 1962 Atlantic Acceptance paid British Mortgage & Trust \$2,250,000 to retire certain outstanding notes. Between November 1 and November 8 the trust company loaned back to Atlantic \$3,000,000 for new securities. Indeed, between January 1, 1962 and May 31, 1965 it would have been in breach of section 142 for a total of 15 months, but never at any year-end; yet during the period the section was contravened by it at some time during each year. The annual returns to the Registrar never revealed this flouting of the statute, because at the point in time which they represented, British Mortgage & Trust was back, as it were, "on side". The Act specifically states that this type of breach of limitation is prohibited and there is no requirement that a company should simply be in compliance with the provisions of the section at the end of its fiscal year. Cecil Richards, the Registrar, who testified before the Commission on May 11 and 12, 1967, after saying that he had, at the time under review, confidence in the competence of Wilfrid Gregory and absolute confidence in his integrity, made the following severe comment upon this practice in answer to a question put to him by Mr. Shepherd:²

"Q. . . . Evidence came before the Commission to the effect that from time to time, particularly in the year 1962, British Mortgage & Trust invested sums in the short term notes of Atlantic Acceptance greatly in excess of the authorized limit permitted by the Act. Indeed, during the course of 1962, at one time, according to the evidence before the Commission, they had funds invested in the short term notes of Atlantic in the order of 300 per cent of the limitation. When the company followed the practice at the end of its fiscal year, ending 31st October, of selling these notes or being repaid the notes which were made so that they fall due in October, and at the end of October the company would be within the limitations of the Act, then, in the month of November the company loaned substantial sums in excess of the limitation back again on the same type of investment. One suggestion put forward was that perhaps the Department should adopt the practice of arbitrarily and without prior notice, during the course of the year, to send a telegram to all trust and loan companies requiring them to report as at the end of the previous day's business on their investment, and such other information as might be necessary to test whether they are in compliance with the Act. Is such a practice necessary or desirable?

A. I don't think it should be necessary. I think in any examinations that have been made regularly the examiner reviews the operations for the full period; he doesn't just look at the balance sheet as at a particular date, he reviews the operations during the past year and the operations since the end of the fiscal year up until the time he is making that examination, that an examination in 1962 should have revealed this fact, and any suggestion of grossly over-investing beyond the limits

²Evidence Volume 121, pp. 16409-11.

in the Act and then covering it up by window dressing at the end of the fiscal year is an indication of a most serious nature, and it's the sort of thing that would destroy any confidence that we had in the management of a company that was doing that sort of thing and there, I think, a very substantial penalty should be able to be charged against them."

Clearly what Richards is here referring to is a deliberate act of evasion and not a mere inadvertence. Gregory explained the matter in a number of lengthy answers to counsel's questions and they must in fairness be quoted in full.³

"Q. Evidence is before the Commission respecting investments made by British Mortgage in the notes, and like, securities of Atlantic Acceptance Corporation Limited, and as you are aware, the company was subject to certain limitations, and the evidence was that in the year 1962 when the first apparent breach occurred, the company was subject to a limitation in the order of \$3 million, that is the limitation of the 15 per cent of capital and reserves, plus 5 per cent of guaranteed investment funds, and deposits, as I recall. Is that correct? The evidence was that throughout virtually the whole of the year, the fiscal year ending 31 October, 1962, Atlantic was over that limitation by varying amounts, but at its highest, Atlantic had—correction—British Mortgage had investments in Atlantic securities in the order of \$10 million. Can you assist us at all as to how the breach occurred, whether anyone was aware that there was a breach, and why it was cured, at least temporarily, immediately prior to the year end 31 October, 1962?

A. Mr. Shepherd, would you mind dealing with the other three years too?

Q. Yes, certainly. Perhaps you would like to look at chart Exhibit 4292. The black line—the solid black line, Mr. Gregory, is investments in Atlantic alone, and the other line on that chart, with which we are now concerned in this line of questioning, is the red line, which is the limitation. Now, with the advantage of the chart in front of you, can you assist us in this?

A. Yes, we are referring now to the years 1962, '63 and '64, I see, yes.

Q. 1962 is the first year of apparent breach, perhaps you could start there and explain this matter to us.

A. Well, I know that—I just don't follow it quickly, but I know we were over. I was very concerned about the evidence given before, and I made it my point to look into it carefully, because it was the first time I was aware—not the first time that I was aware there might not have been occasions when we were over, but I was not aware of it as we went along, and I certainly did not authorize it. Now, how I think this happened is that we started again with Mr. Gordon getting into the short term money market back in 1960, '61, and as we got more and more funds available, it started to grow in the millions of dollars each

³Evidence Volume 116, pp. 15901-9.

year, and we had to do something with these funds at certain times, between the time they came in and the time they went out on mortgage commitments. So, they were put into short term money and I am afraid that we started thinking that too much money was being put into the bank, some would be on demand, some would be for seven days, others would be for three months and I think six months was the highest, and I grant—and then in addition to that Mr. Gordon was approached and came up with the idea of doing some offsets which consisted of taking loans from other companies who did not want to do business with a certain company, and asking us if we would do it, and pay $3\frac{3}{8}$ per cent for doing it.

Q. Another company which for some reason would not buy Atlantic notes?

A. Yes.

Q. They lent money to you?

A. Yes.

Q. And you would take that money and lend it to, let us say, Atlantic?

A. Yes.

Q. At a slightly higher rate of interest?

A. Yes.

Q. Is that what you mean by offset?

A. Yes, so these offsets are added to it. Now, 1964—1962, I am sorry, we were as I mentioned earlier, in a state, we were building a new office building into which we moved in July, and people were practically sitting on each other's knee around the old company, and I can see some reason for it getting out of hand there. It began to be better in 1963, and we got Mr. Anderson, the controller, in 1962, the Fall of 1962, and I knew that our whole accounting was weak, and Mr. Anderson told me the other day, when I asked him about this, he said, 'Well, I thought I was keeping pretty close tab on Mr. Gordon', and I asked him about these things and Mr. Gordon was not there, but I asked his Chief Clerk, who actually did the entries, and she said, 'Mr. Gordon used to ask me a lot how we were doing', and she said he was trying to keep track. And, by 1965, the critical year, we were back under control. We had this thing licked, but I found, and I am not just sure what it was, whether it was 1963 or somewhere along there, that Mr. Gordon had not been counting his offsets as part of our amount we were lending to Atlantic, but our own money that we put in that they—he was keeping under when he got an offset, he had that in a separate category which were a different branch, and so I pointed this out to him and the thing came back in line but it was just one of those things of bringing a company under control, I am afraid, and I feel very badly about the fact it happened, because we did make a real effort to abide by the Act, as you have heard in various evidence that has come up from here and there, that we are always trying to be under the Act.

Now, you have asked me why at the end of each year it came down. Well, this is a common practice for about three reasons. I think in a financial institution, to bring these short term moneys or loans under control, first of all you always try to get loans paid off, short term loans paid off once a year. Banks do this, and we did it, and so the time to do it was towards the end of your financial year, when you wanted to have a liquid position for your balance sheet, and this once again is very common. You see it referred to in the press, banks selling bonds to be liquid for the end of the year and we wanted that. And, the other reason we did not want, we were growing quite rapidly, but we did not want to inflate our assets with what we considered as temporary money, and so we asked, as a matter of policy, that these offset loans would not go over the end of our fiscal year, that they would be paid off before then, and then if we still wanted to lend them to the lender we could start in again, but they were only temporary money. I know that along in 1965 we had about \$20 million out in short term money. Ironically I was trying to keep short term because I could see the rise in interest rates coming, and I wanted at that time to go into longer term bonds. I could not go into short term bonds, and treasury notes without losing money on every dollar I had, and Atlantic gave the best return. John Gordon had asked for the best interest he could get from a group of borrowers, and he got the best return from them, but even by 1965 when we got into trouble with Atlantic, we went down—Atlantic only owed us \$2,400,000 in short term money, and we had that much, practically that much in two or three other finance companies, but I am afraid it was a management problem of just bringing the whole thing under accounting control.

Q. I am puzzled, Mr. Gregory, on looking at the chart to see that at the end of September, 1962, the investment from Atlantic is in the order of 10 million, and by the end of October it is down comfortably in the order of 3 million?

A. Yes.

Q. But in November it is back up to something approaching 5½ million again. This to me at least indicates that this was not happening by mere inadvertence or by Mr. Gordon's misunderstanding respecting the offsets but rather shows the sign of a conscious intelligence being applied to the problem in getting back on base, long enough to file the report with the Registrar, and then going back up again.

A. Well, we not only got back on base, as you put it, to pad the report, we were away under it, and it is because of the reasons I have said, at the end of each year, the end of each fiscal year, we not only wanted to be sure that we were on side, and we wanted that all the time, but we wanted it away down, we wanted it paid off. Now, we still had that money, if they were paid off then our balance sheet at the end of the year, we would have two or three million dollars cash. Well, cash does not earn you a cent, and we would have to start doing something with it right away, and it went up a little bit, as you say it went up, two or

three million, but it had come down from seven, and that one year was the bad one, and I looked over all the notes for the year for the first time the other day, and it is just a peak at the end, and you can see how it happens if you forget your overlap and you have got these things and instead of bringing these ones falling due, before you put some more out, you might overlap for two or three weeks, and this was—it was poor work, there is no doubt about it. As I say, I certainly did not authorize it, and it would have been—and I checked on these things finally in 1963,—what we finally started every morning, Mr. Gordon and Mr. Anderson would meet with me for half an hour, and we would go over what amount of money we had on hand, and then Mr. Gordon was given authority to go ahead, and we checked against our commitments, and then he was told how much to pay out. Well, that then was in his discretion. He put it out, but we checked with him on these amounts, and we were—and it was a growing organization, Mr. Shepherd, and you and—and we were weak on accounting, for a while Mr. Gordon was new, we did try to strengthen it. I could not hire an accountant early in 1962. I tried, and finally got one, but we did not have much of an office, and it was just one of those problems. There was certainly no desire to do it.”

According to Richards there was no question of an “offset” of the type described by Gregory being considered exempt from the limitations of section 142. The “John Gordon” referred to in this evidence was J. D. Gordon, assistant treasurer of British Mortgage & Trust Company, who had been employed by it in that office since September 1958 and also acted as personnel and office manager. He was a graduate of the School of Business Administration at the University of Western Ontario in 1956 and, until the arrival of James R. Anderson in September 1962, he was responsible to the managing director for all the accounting of the company as well as the personnel and office management work. He testified to the Commission on May 9, 1967⁴ and said that he was also responsible for the physical execution of orders for the purchase and sale of securities under Wilfrid Gregory’s direction and the custody of the securities held by or pledged with the company. In these matters he reported directly to the managing director and when, according to Gregory, he involved British Mortgage & Trust in those massive breaches of section 142 of the Act in 1962 he must have been a much overworked young man of 28 years of age. One further illustration of the year-end investment fluctuations dealt with in Gregory’s evidence should also be quoted.⁵

“Q. . . . British Mortgage and Trust in respect to its Aurora note bought notes, bought them with a small discount as did some other purchasers?

A. It was issued—they were issued at 95 were they not?

Evidence Volume 119.

Evidence Volume 115, pp. 15681-2.

Q. Yes. Not all purchasers, I think got the discount, but British Mortgage and other significant purchasers did: in the result British Mortgage had 117,000 outstanding in respect of notes of Aurora on the 27th of October, 1961, according to the evidence before this Commission. British Mortgage sold those notes to Annett. The notes were not qualified of course for investment and would have to be included in the basket clause—if retained over the year end for report to the registrar. That date being the 31st of October, 1961. On the 13th of November, British Mortgage and Trust bought the notes back again from Annett for \$120,000 over the basket clause.

Can you assist me as to why this transaction took place?

A. Well, I presume it took place if you say we were over our—and I don't know that we were.

Q. I don't know that you were over the basket clause?

A. But apparently we didn't want to show this over the year end statement. I presume that is the situation.

THE COMMISSIONER: Is this quite a usual device?

A. It is not uncommon, sir.

Q. Yes?

A. You can run into temporary problems when you make investments when they are available at some time and you can't shift something else out fast enough to—or to advantage and you have to have an overlap and that overlap occurred towards the end of the year. Well, you just naturally have to put things in order."

From the foregoing it would appear that the problem of getting "on side" for the purpose of making the annual report to the Registrar was a recurrent one. The "basket clause" applicable to trust companies is section 140:

"140 (1) Subject to subsection 2, a registered trust company may, with respect to its funds and with respect to moneys received for guaranteed investment or as deposits under section 82 or 80, make investments and loans not authorized by section 139, so long as the total book value of the investments and loans so made and held by the company, excluding those that are or at any time since acquisition have been eligible apart from this section, do not exceed 15 per cent of the company's unimpaired paid-in capital and reserve.

(2) This section does not enlarge the authority conferred by this Act to invest in or lend on the security of real estate, mortgages, charges or hypothecs, and does not affect the operation of the proviso in subsection 1 of section 139. R.S.O. 1960, c.222, s.140."

It will be necessary to quote section 139 at some length.

"(1) A registered trust company may invest its funds and moneys received for guaranteed investment or as deposits in any of the securities

mentioned in subsection 1 of section 137 and may so invest in real estate for the production of income either alone or jointly with any other corporation or with any insurance company incorporated in Canada, provided that at all times at least 50 per cent of moneys received for guaranteed investment in the manner authorized by subsection 1 of section 82 or as deposits in the manner authorized by subsection 1 of section 80 shall be invested in or loaned upon such securities only as are authorized by *The Trustee Act*. R.S.O. 1960, c.222, s.139(1); 1960-61, c.48, s.4(1).

(2) The total book value of the investments of a registered trust company in real estate for the production of income shall not exceed, in the case of its funds, 5 per cent of the book value of such funds and, in the case of moneys received for guaranteed investment or as deposits, 5 per cent of such moneys held by the company or 25 per cent of the company's unimpaired paid-up capital and reserve; provided that the amount invested in any one parcel of such real estate by a company shall not exceed 1 per cent of the aggregate of the book value of its funds and of the moneys held by it for guaranteed investment or as deposits. R.S.O. 1960, c.222, s.139(2); 1960-61, c.48, s.4(2).

(3) In addition to investments it may make by lending on the security of or by purchasing mortgages, charges or hypothecs upon real estate pursuant to the *National Housing Act* (Canada) or the *National Housing Act, 1954* (Canada) or any amendments thereto, a registered trust company may invest its funds to an aggregate amount not exceeding 5 per cent thereof and may, notwithstanding subsection 1, invest moneys received for guaranteed investment or as deposits under sections 82 and 80 to an aggregate amount not exceeding 5 per cent of such moneys, in any other classes or types of investments pursuant to the said Acts, or any amendments thereto, including the purchase of land, the improvement thereof, the construction of buildings thereon, and the management and disposal of such lands and buildings. R.S.O. 1960, c.222, s.139(3).

(4) Subject to the proviso in subsection 1, a registered trust company may lend its funds and moneys received for guaranteed investment or as deposits on the security of,

- (a) any of the securities mentioned in clauses *a*, *aa*, *ab*, *b* and *d* of subsection 1 of section 137;
- (aa) improved real estate or leaseholds in Ontario or elsewhere where the company is carrying on business, but the amount of the loan, together with the amount of indebtedness under any mortgage, charge or hypothec on the real estate or leasehold ranking equally with or superior to the loan, shall not exceed two-thirds of the value of the real estate or leasehold;
- (ab) improved real estate or leaseholds in Ontario or elsewhere where the company is carrying on business, notwithstanding that the amount of the loan exceeds two-thirds of the value of

the real estate or leasehold, if the loan is an approved loan or an insured loan under the *National Housing Act, 1954* (Canada) or any amendments thereto;

- (ac) guaranteed investment certificates of a trust company;
- (b) the bonds, debentures, notes, stocks or other securities of any company or bank, other than those mentioned in clause *d* of subsection 1 of section 137 provided that the market value of the securities on which the loan is made at all times exceeds the amount of the loan by at least 20 per cent of the market value, and provided further that the amount loaned on the security of the stocks of any such company or bank does not at any time exceed 10 per cent of the market value of the total outstanding stocks of such company or bank. R.S.O. 1960, c.222, s.139(4); 1961-62, c.74, s.5."

Section 139 just as clearly requires quotation of the first subsection of section 137 which is expressed to be applicable to loan corporations and loaning land corporations, but is made applicable to trust companies by the first and fourth subsections of section 139.

"(1) A registered loan corporation and a registered loaning land corporation may purchase or invest in,

R.S.O. 1960, c.222, s.137(1), *part.*

- (a) mortgages, charges or hypothecs upon improved real estate or leaseholds in Ontario or elsewhere where the corporation is carrying on business, but the amount paid for the mortgage, charge or hypothec, together with the amount of indebtedness under any mortgage, charge or hypothec on the real estate or leasehold ranking equally with or superior to the mortgage, charge or hypothec in which the purchase or investment is made, shall not exceed two-thirds of the value of the real estate or leasehold;
- (aa) mortgages, charges or hypothecs upon improved real estate or leaseholds in Ontario or elsewhere where the corporation is carrying on business, notwithstanding that the amount paid for the mortgage, charge or hypothec exceeds two-thirds of the value of the real estate or leasehold, if the loan for which the mortgage, charge or hypothec is security is an approved loan or an insured loan under the *National Housing Act, 1954* (Canada) or any amendments thereto;
- (ab) mortgages or assignments of such life insurance policies as have at the date of the purchase or investment an ascertained cash surrender value admitted by the insurer; 1961-62, c.74, s.4(1).
- (b) the debentures, bonds, stock or other securities of or guaranteed by the government of Canada or of or guaranteed by the government of any province of Canada, or of or guaranteed by the government of the United Kingdom, or of any of Her Majesty's

dominions, colonies or dependencies, or of any state forming part of any such dominion, colony or dependency, or of or guaranteed by any foreign country or state forming part of such foreign country where the interest on the securities of such foreign country or state has been paid regularly for the previous ten years, or of any municipality or school corporation in Canada or elsewhere where the company is carrying on business, or guaranteed by any municipal corporation in Canada, or secured by rates or taxes levied under the authority of the government of any province of Canada on property situated in such province and collectable by the municipalities in which the property is situated;

- (c) the bonds, debentures or other securities issued or guaranteed by the International Bank for Reconstruction and Development established by the Agreement for an International Bank for Reconstruction and Development approved by the *Bretton Woods Agreements Act* (Canada), if the bonds, debentures or other securities are payable in the currency of Canada, the United Kingdom, any member of the Commonwealth or the United States of America; R.S.O. 1960, c.222, s.137(1), cls(b,c).
- (d) the bonds, debentures, debenture stock or other securities of any company or bank incorporated by Canada, or by any province of Canada, or by any former province now forming part of Canada, that are secured by a mortgage or hypothec to a trust company either singly or jointly with another trustee upon improved real estate of such company or bank or other assets of such company of the classes mentioned in clauses a, aa, ab and b; R.S.O. 1960, c.222, s.137(1), cl. (d); 1961-62, c.74, s.4(2).
- (e) the bonds or debentures of a company or institution incorporated in Canada that are secured by the assignment to a trust company in Canada of payments that the Government of Canada has agreed to make, if such payments are sufficient to meet the interest as it falls due on the bonds or debentures outstanding and to meet the principal amount of the bonds or debentures upon maturity;
- (f) the bonds or debentures of a company or institution incorporated in Canada that are secured by the assignment to a trust company in Canada of payments that are payable, by virtue of an Act of a province of Canada, by or under the authority of the province, if such payments are sufficient to meet the interest as it falls due on the bonds or debentures outstanding and to meet the principal amount of the bonds or debentures upon maturity; R.S.O. 1960, c.222, s.137(1), cls.(e,f).
- (g) obligations or certificates issued by a trustee to finance, for a company incorporated in Canada or for a company owned or

controlled by a company so incorporated, the purchase of transportation equipment to be used on railways or public highways, if the obligations or certificates are fully secured by,

- (i) an assignment of the transportation equipment to, or the ownership thereof by, the trustee, and
 - (ii) a lease or conditional sale thereof by the trustee to the company; 1961-62, c.74, s.4(3).
- (h) the bonds, debentures or other evidences of indebtedness of any company or bank that has paid regular dividends on its preferred or on its common stocks for not less than five years immediately preceding the date of the purchase or investment, or the bonds, debentures or other evidences of indebtedness of any company or bank that are guaranteed by a company or bank that has paid regular dividends on its preferred or on its common stocks for not less than five years immediately preceding the date of the purchase or investment, provided that at the date of the purchase or investment the amount of bonds, debentures and other evidences of indebtedness so guaranteed is not in excess of 50 per cent of the amount at which such preferred or common stocks, as the case may be, are carried in the capital stock account of the guaranteeing company or bank;
- (i) the preferred stocks of any company or bank that has paid regular dividends upon such stocks or upon its common stocks for not less than five years immediately preceding the purchase of the preferred stocks;
- (j) the fully-paid common stocks of any company or bank which, in each year of a period of seven years ended less than one year before the date of purchase or investment, has paid a dividend upon its common stocks of at least 4 per cent of the average value at which the stocks were carried in the capital stock account of the company or bank during the year in which the dividend was paid; or
R.S.O. 1960, c.222, s.137(1), cls.(h-j).
- (k) real estate in Canada for the production of income, either alone or jointly with any other corporation or with any insurance company incorporated in Canada,
- (i) if a lease of the real estate is made to, or guaranteed by, a company that has paid a dividend in each of the five years immediately preceding the date of investment at least equal to the specified annual rate upon all of its preferred shares, or that has paid a dividend in each year of a period of five years ended less than one year before the date of investment upon its common shares of at least 4 per cent of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid,

- (ii) if the lease provides for a net revenue sufficient to yield a reasonable interest return during the period of the lease and to repay at least 85 per cent of the amount invested by the corporation in the real estate within the period of the lease, but not exceeding thirty years from the date of investment, and
- (iii) if the total investment of the corporation in any one parcel of real estate does not exceed 1 per cent of the book value of the corporation's total funds,

and the corporation may hold, maintain, improve, lease, sell or otherwise deal with or dispose of the real estate, but the total book value of the investments of the corporation in real estate for the production of income pursuant to this clause shall not exceed 5 per cent of the book value of the corporation's total funds. R.S.O. 1960, c.222, s.137(1), cl.(k); 1960-61, c.48, s.3."

This labyrinthine process of discovering what a trust company was able to invest in is characteristic of the Loan and Trust Corporations Act, embracing the two kinds of corporation, and bears the marks of piecemeal amendment. Prior to 1912 loan companies and trust companies were governed by separate statutes and the decision to combine them is too remote from our times to be easily explained. It is otherwise in the federal jurisdiction where the corresponding statutes are the Trust Companies' Act,⁶ and the Loan Companies' Act.⁷ To return to the "basket clause", it permitted trust companies to make investments and loans not authorized otherwise by the Act, provided that they did not exceed in the aggregate 15% of their capital stock and reserves.

Before leaving the subject of British Mortgage & Trust Company's contravention of the limitations imposed by the Loan and Trust Corporations Act it may be said that a mere examination of its annual statement to the Registrar would not disclose what had transpired in this respect between one year-end and the next. Although the Registrar was empowered by the Act to send in his own auditors at any time, his practice was to have them make at least one annual inspection of a loan or trust company's records. As late as April 1965 he had only six of these examiners on his staff, and with over 30 trust companies alone to supervise it was inevitable that some were missed in the course of a year. The Superintendent of Insurance at Ottawa, with the same jurisdiction over federally-incorporated companies, experienced the same difficulty, and it may be said as a general observation that the regulatory authorities in both federal and provincial jurisdictions relied upon the good sense and prudence of financial institutions which prided themselves on their stability, the conservative nature of their operations and the

⁶R.S.C. 1952, c. 272.

⁷R.S.C. 1952, c. 170.

important part which they played in the economy of the nation. The ultimate sanction for the Registrar in Ontario to employ against a recalcitrant company was the suspension or cancellation of its registry as provided for in section 124, the first subsection of which reads as follows:

“(1) Upon proof that registry or a certificate of registry has been obtained by fraud or mistake, or that a corporation exists for an illegal purpose, or is insolvent, or has failed to pay its obligations, or has wilfully, and after notice from the Registrar, contravened any of the provisions of this Act, or of the Act or instrument incorporating it, or of any law in force in Ontario, or has ceased to exist, its registry may be suspended or cancelled by the Registrar.”

This provides a drastic remedy, if such it can be called, which, as Richards said, had never been exercised and which would have had a damaging effect upon depositors and investors under guarantee, apart altogether from the shareholders themselves. For this reason it is hedged about with qualifications such as the requirements that any contravention of the provisions of the Act must have been wilful, that the Registrar must give notice to the offending company, that his decision (section 126) may be subject to a hearing and review at which he may confirm or revoke his decision or otherwise modify it, and finally that the company shall have the right of appeal on such decision to a judge of the Court of Appeal. Such a procedure, with the certainty of delay, speculation in the press, and the closing of a trust company's doors to all intents and purposes in the meantime, would, as Mr. Richards said in his evidence, be not only a source of great expense to the company, but might permanently impair the confidence of the public and the possibility in the future of its resuming on favourable terms its functions as a trustee. The subject of the efficacy of regulation must of course be considered again, but what distinguishes an examination of the affairs of British Mortgage & Trust Company from those of Atlantic Acceptance Corporation, and others involved in this report, is that in the case of the trust company an apparently elaborate system of regulation was in effect, created by a statute bristling with limitations and penalties which, if it had been rigidly applied by a large and ubiquitous staff of civil servants, could have strangled the industry, and as it was applied by the Registrar, with an unduly small staff which he considered chronically underpaid, required the greatest delicacy and tact.

Securities of the Atlantic Complex: Collateral Loans and Investments

The final section of the two-page schedule of investments of British Mortgage & Trust Company relating to the Atlantic complex shown on Table 69 is a list of loans made to persons and corporations secured by the pledge of shares, debentures or notes. Section 139(4)(b), already

quoted in the form applicable in 1964 to these collateral loans, must be read together with section 141(1) which stated:

“A corporation may take personal security as collateral for any advance or for any debt due to the corporation.”

By the provisions of section 137(1)(*d*) a company is authorized first to invest in the bonds, debentures, debentures stock or other securities of a Canadian company secured by a mortgage or hypothec to a trust company on the improved real estate of such company or other assets such as mortgages, assigned life insurance policies or government bonds, the last including those guaranteed by governments of the British Commonwealth and Empire and, under certain circumstances, by foreign governments. Looking then at clause (*h*), it may also invest in the bonds, debentures or other evidence of indebtedness of a company which has paid dividends on preferred or common stock for five years, or the same securities of a company guaranteed by another company similarly qualified, provided that the securities so guaranteed do not exceed 50% of the amount at which such preferred or common stocks of the guaranteeing company are carried in its capital stock account. The debentures of Commodore Business Machines, for instance, at the time when they were pledged as collateral for loans made by British Mortgage & Trust, did not qualify under the joint effect of these provisions, and one is then obliged to look at section 139 which by subsection (4)(*b*) provides that a trust company may invest its own funds and at least 50% of its guaranteed funds in

“the bonds, debentures, notes, stocks or other securities of any company or bank, other than those mentioned in clause *d* of subsection 1 of section 137, provided that the market value of the securities on which the loan is made at all times exceeds the amount of the loan by at least 20 per cent of the market value, and provided further that the amount loaned on the security of the stocks of any such company or bank does not at any time exceed 10 per cent of the market value of the total outstanding stocks of such company or bank.”

The debentures of Commodore Business Machines might have qualified under this provision, provided that British Mortgage & Trust did not lend against them more than 80% of their “market value”, a term not defined in the Act and the meaning of which invited dispute. Finally the trust company could rely on its “basket clause” (section 140). This section allowed the company to invest and lend anything up to 15% of its “unimpaired” capital and reserve, free of limitation except as provided in section 142, and by the provision also contained in subsection (1) of section 139 that at least half of its guaranteed funds must be invested in or lent upon trustee securities, being government bonds, first

mortgages and other securities authorized by the Trustee Act.¹ As for investment by trust companies in "stock", again not defined in the Act, it would appear that the effect of all these sections was to permit a trust company to contend that it could lend on the security of the shares of any company provided that the loan did not at any time exceed 10% of the market value of all such company's stock, both preferred and common, a contention, be it said, that British Mortgage & Trust in the person of its managing director did not hesitate to assert. The Registrar, however, took the position, admittedly without statutory authority but pursuant to the view that he had discretion to interpret, or at least to rule, on how the Act should be applied, that a trust company was only authorized to invest under the provisions of section 139, read in conjunction with those of 137, in issues which had a continuous record of paying dividends for seven years and only to the extent of 80% of a real market value.

Shortly after the extent and effect of this controversy was revealed by the investigations of this Commission the Ontario Legislature in 1966 amended section 139(4)(b) to embody the Registrar's view.² Amongst other amendments was an addition to section 141, also quoted above, permitting a corporation to take personal security for any advance or debt due to it as collateral, and adding the words "in addition to the security required by this Act"; moreover a new subsection (3) was enacted in the following terms:

"No director or other officer of a corporation and no member of a committee of a corporation shall accept or be the beneficiary of any consideration or benefit for or on account of the negotiation of any loan, deposit, purchase, sale, payment or exchange made by or on behalf of the corporation."

This last addendum, simply enshrining in the statute prohibition of the abuse of a fiduciary obligation which any director of a trust company might have been expected to regard as a rule of honourable conduct, may also be attributed to the situation prevailing in British Mortgage & Trust Company revealed by the evidence given to this Commission.

The Commission was advised that the normal practice of trust companies making collateral loans, which in this connection are loans evidenced by a promissory note and collaterally secured by the pledge of securities, is, and was at the time material to this investigation, not to accept as security shares or obligations which they were not authorized to invest in, and to insist in this respect on standards at least as high as those maintained by the chartered banks. It remains to be seen how the collateral loans made by British Mortgage & Trust Company,

¹R.S.O. 1960, c. 408.

²14-15 Elizabeth II, c. 81 s. 11.

as set out on page 2 of Table 69, conformed to these self-imposed counsels of prudence. The first arose in 1962, consisting, as has been seen, of a loan of \$480,000 to C. P. Morgan secured by 25,000 second preference shares of Atlantic Acceptance with a market value of \$600,000, determined by trading on the Toronto Stock Exchange. Atlantic had been paying dividends regularly on its first issue of preference shares since 1954 and the advance by British Mortgage & Trust was within the 80% limitation. The loan was repaid in 1963 and was the only collateral loan made in 1962. In 1963 the company lent \$136,250 to Annett Partners Limited against the pledge of Commodore Business Machines Series "A" debentures with a face value of \$100,000 and Aurora Leasing convertible unsecured notes with a face value of \$20,000. Market value for the debentures was established by the company on the basis of a valuation given by Annett & Co. as \$120 for each \$100 of face value for the debentures and \$133 for each \$100 of face value of the notes, giving an aggregate market value of \$146,600. The attribution of market value to Annett & Co. was, it must be said, merely based upon a note in the auditor's working papers. In any event it was the practice of the Registrar to require a trust company to keep on file some evidence as to how the market value in these cases had been determined, especially in the case of unlisted securities. This loan was repaid in 1964. A much larger loan of \$500,000 was made in 1963 to D. R. Annett, C. G. King, W. L. Walton, Manfred Kapp, Jack Tramiel, C. P. Morgan and Harry Wagman in amounts of \$100,000 each to Morgan, Tramiel and Kapp and \$50,000 each to Walton, Wagman, Annett and King, for a total of \$500,000 for which the collateral was \$500,000 worth of Commodore Business Machines Series "B" debentures. The total issue of these debentures had a face value of \$600,000, with the remaining \$100,000 worth taken up by J. A. Medland, and additional security of 42,725 common shares of Commodore Business Machines was pledged. British Mortgage & Trust valued the debentures at par and the common stock at \$4.40 per share, giving a total value of \$687,990. Information on which this valuation was based was given to the Registrar in the annual statement at October 31, 1963.³ This loan remained unpaid at July 31, 1965 and the securities pledged, as will be recalled, were the subject of a particularly advantageous settlement made with Victoria and Grey Trust Company, by which the former recovered moneys which its management believed to be irretrievably lost, and Messrs. Tramiel and Kapp were able to retain, with the assistance of Irving Gould, control of their enterprise.

A remarkable concentration of loans was made to closely connected individuals. For instance, Mrs. Kathleen Lelandais, the wife of a

³Exhibit 2561.6.

Lambert partner, borrowed \$20,000 and gave as collateral security \$25,000 worth of Western Heritage 7% debentures; here the proportion of the loan to the security was exactly 80%. E. G. Poindexter borrowed \$160,000, pledging Western Heritage debentures to the face value of \$200,000—again 80%. Kathleen Christie, wife of Alan T. Christie, a Lambert partner and president of Great Northern Capital Corporation, the parent company of Western Heritage Properties, borrowed \$80,000, pledging \$100,000 worth of Western Heritage debentures; Charles Bensing, a director of Western Heritage, borrowed \$20,000, pledging \$25,000 of that company's debentures; J. F. Hartzel borrowed the same amount lent against the same security; and Carman G. King, another director of Western Heritage, borrowed \$80,000 against \$100,000 of the same debentures. The aggregate of these loans amounted to \$380,000 for which Western Heritage 7% debentures, due June 30, 1973, having a face value of \$475,000, were pledged. All the borrowers were connected with Western Heritage Properties and Great Northern Capital Corporation; British Mortgage & Trust Company treated the debentures as having a market value at par and did not see fit to require any guarantee from their husbands of the notes given by the two borrowers who were married women. The next and last collateral loan in 1963 to individual persons involved in the Atlantic complex was another of \$24,000 made on July 20 to Wilfrid Gregory's old friend Carman G. King. The collateral security was a note of General Spray Service Inc., due September 30, 1972, with a face value of \$30,000⁴ and at the time this company was subject to bankruptcy proceedings in New York, with effect from October 1963.⁵ This loan was paid off in the following year.

At the beginning of 1963 British Mortgage & Trust had made a loan to Western Heritage Properties itself of \$500,000 at 7% which was collaterally secured by the assignment of a promissory note of Sherwood Properties Limited, payable to Western Heritage in the principal sum of \$1,000,000. The published report of Western Heritage for the year 1964⁶ showed comparative figures for the previous fiscal year ended December 31, 1963. Sherwood Properties was a subsidiary company of Western Heritage, incorporated to develop property known as Sherwood Park, a housing development near Edmonton, Alberta. The financial statement for Sherwood Properties for the year ended October 31, 1964⁷ audited by Deloitte, Plender, Haskins & Sells, also showed comparative figures for a previous year and at October 31, 1963 there was, according to the statement, a deficit of \$336,744 and a net loss on

⁴Evidence Volume 41.

⁶Exhibit 2325.

⁷Exhibit 4314.

⁸Exhibit 4315.

operations for the year of \$206,995. As for its parent company, the shareholders' equity of Western Heritage at the end of 1963 was \$1,101,250 after a loss for the year of \$123,580. The \$1,000,000 security for the loan of British Mortgage & Trust, described as being in the form of a note of Sherwood Properties, was actually calculated from three amounts, the first being \$250,007, represented by a 5% note from Sherwood Properties to Western Heritage due December 18, 1965; the second \$501,250, represented by notes similarly payable and due on the same date and the third consisted of \$248,743.55, assigned to British Mortgage & Trust as part of the collateral, being a portion of 6% notes payable to Western Heritage by Sherwood Properties amounting to \$507,274 due December 18, 1966. Note 2 to the balance sheet of Sherwood Properties explained that the 6% notes payable on December 18, 1966, bearing interest at 5%, were subordinated to the 5% notes payable December 18, 1965, referring to the two amounts of \$250,007 and \$501,250, both being part of the trust company's collateral security. If the promissory notes of Sherwood Properties had a market value of \$625,000, the British Mortgage loan of \$500,000 was not more than 80%, but, as will be observed on Table 69, this loan, which bore interest at a higher rate than the notes representing the collateral security, was still outstanding in the full principal amount at July 31, 1965. The collateral loans outstanding at October 31, 1963, which have not all been referred to, amounted in the aggregate to \$1,510,250, out of a total of all such loans made by British Mortgage & Trust of this nature at that date amounting to \$1,635,887; it is abundantly clear that by that date virtually all of the company's collateral loans had been made to C. P. Morgan, Carman King and companies and individuals introduced by them.

Holdings of Atlantic Complex Securities in 1964 and 1965

The collateral loans originating in 1964, taken in the order in which they appear on Table 69, were six in number. The first was made to N.G.K. Investments, which gave British Mortgage & Trust a note for \$250,000 with collateral security, and was the subject of a letter from Wilfrid Gregory to C. P. Morgan, dated April 28, 1964,¹ which should be quoted because of the arrangement made for bonus which is characteristic of other loans.

"Dear Powell:

Re: N.G.K. Limited

Further to our telephone conversation I now enclose herewith cheque payable to N.G.K. for \$250,000. This is a demand loan at 7% on the

¹Exhibit 1250.

security of \$315,000 worth of securities. \$250,000 of these securities are to be convertible debentures of Series B of Commodore Business Machines (Canada) Limited. The balance should be securities with assured market value i.e. common stock of Commodore.

We also enclose herewith note and hypothecation form. As consideration for making this loan we are to receive all the warrants attached to the \$250,000 worth of the said Commodore convertible debentures which will become the property of this Company as part of the consideration for making the loan.

We shall expect to receive all the securities and documents at your early convenience.

Yours sincerely,

‘Wilf’ ”

The trust company received as collateral \$250,000 Series “C” 7% convertible debentures and 17,667 common shares of Commodore Business Machines, together with warrants for purchase of a further 25,000 shares, according to receipts given to N.G.K. Investments on June 9, 1964.² N.G.K. Investments obtained 17,500 of the shares in July 1962 from Evermac Office Equipment Company in exchange for 50,000 common shares of Pearlsound Distributors, a Morgan-Tramiel transaction previously described,³ and the debentures at a discount from Commodore Business Machines for a price of \$237,500. It will be seen that the amount of this loan, as shown on Table 69, is \$240,000, outstanding at October 31, 1964 as well as June 31, 1965. This reduction does not represent any repayment, merely the fact that British Mortgage & Trust attributed a value of \$10,000 to the warrants annexed to the Commodore Business Machines debentures which it took as a bonus for making the loan and thus reduced the book value of the latter by that amount. Contemporaneously, on April 29, another loan was made to Associated Canadian Holdings, a company owned by Morgan, Tramiel and Kapp, but in which, unlike N.G.K. Investments, Wilfrid Gregory had no interest. This company also unloaded Commodore Business Machines Series “C” debentures with a face value of \$250,000, and 18,750 warrants as a bonus, for a loan of \$200,000. According to a letter from Associated Canadian Holdings, dated May 22, 1964 and addressed to J. D. Gordon, British Mortgage & Trust also received an option to buy \$50,000 worth of the assigned debentures as long as the loan was outstanding and for 15 days thereafter. A third loan was made to members of the Annett firm, including the two Annetts and C. G. King, to enable them to purchase 75,000 shares of The Dale Estate Limited at a price of \$1.50 per share plus commission. The underwriting of these shares by Annett & Co. and Morgan, Walton and Wag-

²Exhibits 1251-2.

³Chapter XIV, pp. 938-9.

man through Yarrum Investments has already been referred to in Chapter VIII,⁴ and British Mortgage & Trust was deeply involved as a mortgagee in the financing of this company; Wilfrid Gregory's personal interest in it will be examined in due course. The loan was to bear interest at 7% and Annett & Co., in addition to the Dale shares, would assign their one-third interest in S.A.F. Holdings, described as a partnership holding equity in the Britannica Building at 151 Bloor Street West in Toronto; British Mortgage & Trust valued the shares at \$131,250, the market price at the time, and the interest in S.A.F. Holdings at a market value of \$16,600 base on the borrowers' own valuation. At October 31, 1964 this loan was shown as outstanding in the amount of \$114,375 and had not been reduced at the date of the Atlantic receivership, although by July 31, 1965 \$77,053 had been paid.

A fourth loan was made to Chisholm & Co., *alter ego* of the Lambert firm in New York. The principal amount was originally \$240,000 in Canadian funds, secured by a promissory note, dated March 11, 1964, for one year bearing interest at 7¼ % and subsequently replaced by another for \$190,502.67,⁵ dated September 16, which explains the entry on Table 69. The collateral security was Commodore Business Machines Series "A" debentures with warrants having a face value of \$250,000. This loan was paid apparently in advance of the due date and British Mortgage & Trust did not retain the warrants. Finally two loans appear as having been made in 1964, although actually advanced in December 1963, to Mr. and Mrs. Alan T. Christie of \$75,000 each,⁶ on the application of Carman King.⁷ Mrs. Christie lodged \$10,000 of convertible notes of Aurora Leasing, 7,300 shares of Western Heritage 16,000 shares of Analogue Controls and 50,000 shares of Camerina Petroleum, to all of which Annett & Co. attributed a market value of \$142,100. Alan Christie lodged \$55,000 of Commodore Business Machines Series "A" convertible debentures, 15,000 of Aurora Leasing convertible notes and 12,000 shares of Camerina Petroleum, the market value of which was said by Annett & Co. to be \$102,700. The loan to Mrs. Christie, which was in addition to and not in substitution for the \$80,000 previously lent to her against the security of Western Heritage debentures, was repaid early in October to the extent of \$23,194, upon which \$18,000 of the Commodore Business Machines debentures were released to her. The aggregate of all these collateral loans made to companies and individuals of the Atlantic complex at October 31, 1964 amounted to \$2,460,917 out of a total reported by British Mortgage & Trust at that date of \$2,768,465.

⁴pp. 356-61.

⁵Exhibit 4312.1.

⁶Exhibit 4300.

⁷Exhibit 4300.1.

The annual statement of the affairs of British Mortgage & Trust made to the Registrar as at this date⁸ set out the type of security held against these loans, and its most striking feature is the amount held of the securities of Commodore Business Machines of which Wilfrid Gregory had become a director in November 1963. Debentures were held to the face value of \$1,277,000, represented by \$277,000 of Series "A" and \$500,000 each of Series "B" and "C". In addition the company owned \$50,000 worth of Series "A", and thus held these debentures to the value of \$1,327,000 out of a total issue of \$2,200,000, representing some 60% of the whole; it also held 60,392 common shares as collateral and owned 25,000. At this point, according to the financial statement of Commodore Business Machines for the year ended June 30, 1964, that company had issued a total of 835,550 common shares, so that British Mortgage & Trust held just over 10% of the issued common stock. It also owned 2,795 5½% preference shares, 20,000 second preference shares and 38,170 common shares of Atlantic Acceptance itself. Additional collateral held against the loans referred to were 75,000 shares of The Dale Estate Limited, Aurora Leasing notes to the face value of \$25,000, 62,000 shares of Camerina Petroleum, 16,000 shares of Analogue Controls and \$451,000 of Western Heritage debentures, together with 7,300 common shares of that company and the note of Sherwood Properties for \$1,000,000.

The annual statement for 1964 was the last ever made by British Mortgage & Trust Company and the information about collateral loans outstanding in May, June and at the end of July 1965 on Table 69 was otherwise derived from the company's records. As will be seen by looking again at the graph depicted on Table 70, immediately after the end of the 1964 fiscal year the trust company's investment in the securities of Atlantic Acceptance itself rose sharply and then declined at the end of the calendar year. However, the investment in the whole complex reached a high point of approximately \$14,000,000 by the end of April 1965. This is explained by a loan of \$1,500,000 made to Trans Commercial Acceptance in December 1964, for which the borrower pledged the whole of an issue of Commodore Business Machines' issue of preference shares in the amount of \$1,000,000 and subordinated notes in the same amount which it had acquired from Hugo Oppenheim und Sohn as described in Chapter VIII.⁹ At the same time the company's investment in the notes of Atlantic Acceptance, which was down to \$1,750,000 at the end of December 1964, rose to \$6,500,000 at the end of the following April and had been reduced by \$1,000,000 from that total by the end of May. It will be seen that, at the date of the Atlantic receivership on June 17, the total investment of British Mort-

⁸Exhibit 2561.7.

⁹pp. 399-401.

gage & Trust in Atlantic notes amounted to \$4,150,000 and by the end of the month apparently declined again to \$3,400,000, no doubt due to the reclassification for what it was of the Treasure Island Gardens note to Atlantic Acceptance for \$750,000, which had been endorsed by Atlantic in favour of the trust company and was thereafter reported by the latter as an Atlantic short-term note. Another major lending of the same type in 1965 was the \$480,000 lent to London Lighthouse Investments on a promissory note of that company, also endorsed by Atlantic, in the transaction described in Chapter VII.¹⁰ There was also an increase in 1965 in the investment in the common shares of Commodore Business Machines from a value of \$79,969 to \$202,469. By the end of the last calendar month prior to the date of the Atlantic receivership, or May 31, 1965, the total investment by British Mortgage & Trust in the Atlantic complex, including loans secured by shares and obligations, amounted to \$13,555,372, but not including additional investments made in its capacity as trustee of approximately \$340,000. By June 17, when the receiving order was made, these investments had been reduced but still amounted to \$12,200,517, while the estates, trusts and agencies investments remained approximately the same; at this point the company's holdings in the Atlantic complex, both as owner and pledgee, constituted 60% of all its corporate investments and collateral loans, exclusive of its holding of Government bonds, approximately 12% of its total assets, excluding those held by estates, trusts and agencies as reported for October 31, 1964, and more than 200% of the sum of its capital stock and reserves and undivided profits.

The Dispute with the Registrar of Loan and Trust Corporations

Before 1963 correspondence between the Registrar's office and British Mortgage & Trust was infrequent, largely technical in nature and contained no indication of concern by the regulatory authorities. But in that year an exchange of letters began which developed three main areas of disagreement between the Registrar's examiners, seeking to apply his policy, and Wilfrid Gregory who, as a former practising solicitor and a comparative neophyte in the trust company business, adhered to his own interpretation of certain sections of the Loan and Trust Corporations Act. The whole file of correspondence¹ is particularly instructive and might well be reproduced in full, but because of its length it has been summarized, with the occasional quotation, in order to prepare the ground for the major crisis in 1965. The first point of difference involved the calculation of the total of capital stock and reserve which has already been referred to. In simple terms, the Regis-

¹⁰pp. 279-287.

¹Exhibit 2553.

trar's examiners contended that the amount of reserves which could be added to the value of capital stock in order to determine the 15% ratio limiting investment in any one security should be as shown on the balance sheet, and should not include those amounts which had been deducted from the book value of specific assets in order to give them a realistic value. On the other hand Wilfrid Gregory insisted that what might be described as "allowances for loss" should be added to moneys set aside from undivided profits as general reserve in order to supply a total for the computation of the various ratios which governed the maximum limits for investment, especially in the "basket clause". The argument between the examiners and Gregory during the first three months of 1963 was outlined in the evidence of the Registrar himself, given to the Commission on May 10, 1967.²

"Q. Now, since there is no definition of 'reserves' in the Act, I take it that it was not practical to take the position with Mr. Gregory and make it stick, to use the vernacular, that his calculation of reserves was not acceptable?

A. Well, our general departmental procedure in that respect is that the only reserves that can be added to the capital and general reserves are those reserves that are not required to bring down valuations, the valuation of assets, to reasonable figures. In other words, they should not include investment reserves required to take care of possible losses.

Q. Let me see if I understand that in layman's language. Are you saying that a company is allowed to include in its calculation of the aggregate of capital and reserves for the purpose of determining their right to invest in any security of any one company under Section 142, reserves which are free reserves and are not allocated to any specific and apprehended loss? Would that be correct?

A. Yes, I think that would be.

Q. Let us take an example: If the company in its judgment considers it probable that it will not be able to collect the face amount of a mortgage and therefore sets up a reserve against that mortgage your position, I take it, is that this sum is not a reserve at all in the same sense as the word is used in respect to other matters but is rather an attempt to ascertain the actual value of that asset, and therefore you do not allow the company to take that specific reserve into account in determining the amount of money which it can invest in any one security? Is that right?

A. Yes. Yes.

Q. But if the company sees fit to set up on its own statement a sum of money which it calls a reserve, but is simply a general reserve set up out of prudence and not because they apprehend any specific loss, then you do allow them to add that reserve?

²Evidence Volume 120, pp. 16279-83.

A. Yes. If it is an allocation of real profits for the purpose of setting up a general reserve, then we would allow that; and that, I think, is what is contemplated in the Act.

THE COMMISSIONER: Am I right, Mr. Richards, in thinking that accountants for this reason have drawn a distinction between reserves and allowances and that these specific reserves are called allowances by some chartered accountants in order to draw that distinction?

A. Yes. There has always been some confusion as to the use of the word "reserves" when they are really provisions for losses.

Q. So that whereas you would have to show—see if I understand this—you would have to show your general reserves on the liabilities side of your balance sheet, you could show an asset net of allowance without disclosing the actual amount of the allowance on the assets side?

A. Exactly, yes. And that can be done even for general provisions, not necessarily for specific.

THE COMMISSIONER: I see.

A. For instance, real estate held for sale for instance. Now, they might not anticipate any loss on any particular one, it could be any particular item, but it would be in our opinion desirable to set up some provision for losses on those, and that provision could be deducted from the amount which they carried on the balance sheet.

THE COMMISSIONER: Yes.

MR. SHEPHERD: To enable me to try to understand this, Mr. Richards—and I confess I find it a difficult concept—could I take one example: Let us suppose there is a trust company which has in its whole portfolio only one mortgage for a million dollars; now, do I understand you to say that if a trust company considers that there is risk that they cannot collect a million dollars on that mortgage because the property has deteriorated in value, say, and therefore they set up an allowance of \$100,000, reaching a net of \$900,000, then whether they call it 'allowance for loss', as they could, or whether they call it 'reserves'—as British Mortgage always does—you don't allow that to be taken into account because that sum of \$100,000 is not an asset to the company, it simply represents a bookkeeping entry made to get the value of the assets of the company down to what they would bring on the market?

A. Yes, exactly. Yes.

Q. But if that company which had only one mortgage of a million dollars had no concern about the collectability of that mortgage and they were well content with it, but nonetheless thought in future years we may well start sustaining losses on mortgages and therefore it would be right for us to take out of our profit and set up as reserve the sum of \$100,000 to take care of potential loss, then you would allow that because as of that moment in time at which the reserve is set up, that is an asset of the company and it increases the net worth of the company by \$100,000?

A. Yes."

Wilfrid Gregory won this first round with the department as appears from a letter to him from H. W. Allen, dated March 4, 1963,³ reading in part as follows:

"Further to our previous correspondence and discussion I would now inform you that we calculate your capital and reserves as follows:

Capital Stock	\$1,379,300
General Reserve	2,400,000
Profit and Loss Account	201,029
Mortgage Reserve	559,200
Investment Reserves	947,310
	<hr/>
	\$5,486,839

15% of this total equals \$823,026.

As long as the mortgage reserve remains a general reserve on all mortgages, the total may be included as above. However, if it is found necessary to reserve for any specific mortgage, then the sum so reserved should be deducted from the total mortgage reserve.

While the market value remains in excess of the book value, the total reserves on stocks and bonds may be used as above. If the market value should drop below book, the difference should be deducted from the total investment reserves."

In a later paragraph of the examiner's letter, he says:

"There is one of your mortgages on a short term basis in London for \$1,500,000. This was due to mature on February 28, 1963. Could you please tell me how this matter stands and if all interest payments are up to date."

In his answer, dated March 12, 1963, Gregory replied in the following terms:⁴

"The mortgage on Treasurer Island Shopping Center (*sic*) in London for \$1,500,000 fell into default at the beginning of this year. The owner unfortunately had a fire just before it was completed. This prevented the tenants which he had lined up from taking possession and he was not able to complete his permanent first mortgage financing. We stepped in and are collecting the rents from Fredericks and Busy Bee (Loblaw covenant). These are sufficient to pay the taxes and about 6% interest on our mortgage.

We have given notice of exercising power of sale and are at present negotiating sale of the property. There is owing to us about \$1,700,000. A Vice-President of A. E. LePage who have a second mortgage for \$60,000, states that a purchase of \$1,700,000 would be a 'fantastic bargain'. We do not know about that but we do anticipate getting out of it very shortly at least the amount of our mortgage and full interest owing."

This letter also contained the assertion that British Mortgage & Trust had never lost anything on mortgages, to which Allen replied that he

³Exhibit 2553.1.

⁴Exhibit 2553.

was glad to hear it and wished the company luck in disposing of Treasure Island Shopping Centre, with the observation that, whatever might be LePage's opinion, the market price would be set by what a purchaser in the area would be prepared to pay. On March 27 Gregory advised Allen that his company had entered into an agreement to sell the shopping centre for \$1,700,000 which would "pay off our mortgage and most of the second mortgage." This aspect of the correspondence, dealing with the mortgage to Wildor Holdings for the construction of the Treasure Island Shopping Centre, is singled out because, on the day previous to the date of Gregory's letter to Allen, the board of British Mortgage & Trust had accepted an offer to purchase from Donald Walter Reid in trust for a company to be formed, and on the day that the letter was sent Pike had written to Reid to say that the maximum first mortgage on the property which British Mortgage would take back as part of the purchase price was \$1,100,000, thus giving the Treasure Island project a new lease on life at the trust company's expense.⁵

The second difference of opinion in 1963 concerned the eligibility of the new investments of British Mortgage & Trust Company in the securities of Atlantic Acceptance Corporation. The matter was first raised in a memorandum by Allen to Ernest Dodd, the Chief Examiner, dated January 21, 1963 in which, after raising the question of the proper calculation of the aggregate of capital stock and reserves referred to above, he listed the trust company's investments in the preference and second preference and common shares of Atlantic, with the comment that they would not appear to be eligible, and drew attention to the fact that it held at October 31, 1962 an amount of \$2,605,384.92 of that company's short-term notes. He concluded as follows:

"I would add that Mr. W. P. Gregory of British Mortgage is a director of Atlantic Acceptance and that the branch office of Atlantic Acceptance in Stratford is situated in the new B.M.T. Building.

Finally a Collateral Loan was made to C. P. Morgan, president of Atlantic Acceptance, in the sum of \$480,000, the security being \$600,000 worth of Atlantic Shares. I am not sure if this is significant or not, but I wish to point out the seemingly close alliance between the two companies and the sums involved."

Allen then wrote to Gregory on January 24, 1963, asking for particulars of investments held by British Mortgage & Trust under the "basket clause" and, as a result of the reply from him dated January 28 setting out the information, he wrote again on January 30, saying, with respect to 26,036 common shares of Atlantic Acceptance carried at a book value of \$324,257,

"Atlantic Acceptance—In our opinion none of the holdings in the company are eligible. May we have your comments on this please?"

⁵Chapter VII, pp. 240-3.

To this Gregory replied on January 31:

“Atlantic Acceptance—The common shares of this company are not eligible. The preferred shares are eligible under section 137(1)(i). Two or three months ago we checked with your Head Examiner about the 6% Convertible Preferred Stock. He confirmed my opinion that this issue was eligible under the section quoted.”

It is clear that the correspondents had, in a sense, shifted their ground, in that Allen was using the term “eligible” on the assumption that even securities held in the “basket clause” must conform to the tests of eligibility contained in sections 137 and 139, whereas Gregory took the view that under section 140 the question of eligibility did not arise as long as the investments held thereunder did not exceed 15% of the company’s unimpaired paid-in capital and reserves—a view be it said which, upon a fair reading of the section, was unanswerable—and was now referring to section 137 in direct answer to the examiner’s communication. Section 137(1)(i) provided that:

“137(1) A registered loan corporation and a registered loaning land corporation may purchase or invest in . . .

- (i) the preferred stocks of any company or bank that has paid regular dividends upon such stocks or upon its common stocks for not less than five years immediately preceding the purchase of the preferred stocks.”

The argument over the interpretation of this section was briefly this: the Registrar considered that unless the particular preferred stock invested in had paid dividends for five years before their purchase it was ineligible for investment, and Gregory that if such dividends had been paid on any issue of preferred stock all other preferred issues were qualified, both arguments being based of course on the assumption that dividends had not been paid for five years on the particular company’s common stock which would have qualified them in any event. Gregory obtained an opinion from Osler, Hoskin & Harcourt in Toronto in support of his contention and the Registrar’s department, as late as 1965, corresponded on the subject with the Department of Insurance in Ottawa, which took the same position as the solicitors. Here, however, the Department at Ottawa was construing section 68(1)(h) of the Trust Companies Act (Canada) which is more specific on the point the Ontario Act left in doubt.

- “68(1)(h) preferred stocks of a corporation incorporated in Canada that has paid regular dividends upon such stocks, or upon its other preferred stocks ranking equally therewith or common stocks for not less than five years preceding the purchase of such preferred stocks;”

The new Chief Examiner in Toronto, J. E. Rupert, in requesting the opinion from Ottawa, apparently thought that the two enactments were "almost word for word" and his Ottawa correspondent never adverted to the difference. The situation of Atlantic preference shares provided a good example of what was at stake. The 5½ % preference shares of Atlantic had paid dividends regularly since 1954 but the second preference shares had not paid them regularly for the required period; according to the Registrar, investment in the second preference shares was prohibited and according to British Mortgage & Trust, Osler, Hoskin & Harcourt and the Department of Insurance at Ottawa, it was not. One of the points raised in Ottawa was that if a company had qualified an issue of preference shares by regular payment of dividends for five years immediately preceding the investment, and then created a new issue not so qualified, it automatically disqualified the older issue which had hitherto been considered eligible. One may be permitted to wonder at the expenditure of so much ingenuity on the interpretation of a section which seems perfectly plain when the expression "such stocks" is contemplated. Subsequent correspondence between Gregory and the Registrar and his examiners show that the latter remained unconvinced; the matter was left to be corrected by an amendment to section 137 of the Act in 1966 (14-15 Elizabeth II, c.81 s.10), which apparently advanced the Registrar's position a step further than that maintained by him previously, and it reads thus:

- "(i) the preferred stocks of a company or bank that has paid,
- (i) a dividend in each of the five years immediately preceding the date of investment at least equal to the specified annual rate upon all of its preferred stocks, or
 - (ii) a dividend in each year of a period of five years ended less than one year before the date of investment upon its common stocks of at least 4 per cent of the average value at which the stocks were carried in the capital stock account of the company during the year in which the dividend was paid."

At the time, however, Gregory was again left master of the field.

The third point in dispute which arose first in 1963 and, because of the deficiencies of the Loan and Trust Corporations Act, was not resolved, was also first raised by Allen's letter of March 15 in which he made his comment on the disposal of the Treasure Island Shopping Centre. He concluded that letter as follows:

"The mortgage in Markham would appear to be an ineligible asset. Our policy is that in regard to vacant land in built up urban areas, we are prepared to permit companies to take back mortgages on vacant land, provided the property is fully serviced, but only if it is so. Therefore, a mortgage to pay for the installation of such services is non-

admissible. This could of course be carried under the Basket Clause if you had not reached the limit.

I trust that there are no other mortgages of a similar nature."

Wilfrid Gregory replied to this in his letter of March 27 in which he announced the sale of the shopping centre in these words:

"I am afraid that I cannot agree with you that our mortgage in Markham would appear to be an ineligible asset. We are permitted to take mortgages on improved land. The degree of improvement need be very small. What our actual policy is is to advance money to pay for the services as they are being done. With respect, we do not think your restricted policy in this respect can be supported by the terminology in the Act. We shall be pleased to go into more detail with you about this and discuss it at further length if you so desire."

The disagreement here was, of course, over the meaning of the expression "improved land" in section 137(1)(a) which provided, by the application of section 139(1), that a trust company might purchase or invest in "mortgages, charges or hypothecs upon improved real estate in Ontario or elsewhere where the corporation is carrying on business." "Improved real estate" or "improved land" was not defined in the Act and what constituted improvement was consequently in doubt. The position taken by the Registrar, and its weaknesses from the point of view of the existing law, was well illustrated in the following portion of Richards' examination before the Commission:⁶

"Q. What was the policy of the Department at that time, on what the Department thought improved real estate meant?

A. Well, I think Mr. Allen has set it out that at least it should be in the case of urban properties, a property that had services laid in.

Q. Now, Mr. Gregory not being in agreement with that view, do you agree that it was difficult to show that he was wrong where improved real estate was not defined?

A. It is very difficult to define improved real estate, yes.

THE COMMISSIONER: May I ask you, Mr. Richards, if the money was being lent in order to install services such as water lines and electric power lines and so forth, and this had not been done. How could the vacant land be described in any sense as improved even when the definition of that term in the Act was lacking?

A. Well, I think improved real estate for instance, can include farm lands. That it has been quite a long standing custom for—under that section—for companies to take mortgages on farm land and if a mortgage is made on the basis of a farm valuation then I think, you can say that it is—it would come in as an eligible investment.

⁶Evidence Volume 120, pp. 16302-6.

Q. I see. Where land however, was, we will say, farm land, but was purchased with a view to using it for building land?

A. Yes.

Q. It couldn't surely in any sense be described as improved in the absence of the installation of services, or at least, some grading or something which would change its character. Was that Mr. Allen's point?

A. Yes, that was the point. Yes.

THE COMMISSIONER: Yes, I see.

MR. SHEPHERD: Did you have, from time to time, any discussions with Mr. Gregory on this point?

A. Yes, I believe we did. This was somewhat of a new problem that arose as a result of general urban development and the desire for mortgages for this purpose and we felt, I think, we still feel, that some amendment to that Section is necessary to more closely define just what can and what can not be used as security for these mortgages.

Q. We will return to the detail of any such view you hold later, but have you finally resolved in your own mind up to now, precisely what the change should be?

A. No, I really haven't.

Q. Was Mr. Gregory the first, or was British Mortgage & Trust, the first of the companies to take this position?

A. No, we had the same discussion with some other companies.

Q. Yes?

A. It boiled down really to the valuation that might be placed on this land. We had no objection to placing a mortgage on this land on the basis of farm values, but to base the valuation of that land after it had services installed, was quite a different matter.

THE COMMISSIONER: Supposing you were to take an area of vacant farm land contiguous to an urban community, or where some housing development was clearly justified?

A. Yes.

Q. And put on a subdivision plan consented to by whatever zoning authorities were involved and the Minister of Planning and Development, if there is still such a Minister, would that not constitute improvement over the native state of the land?

A. The fact that there was a zoning and a plan?

Q. Yes?

A. Well, that is questionable. That is, I think, one of the areas we still have to resolve as to what extent these companies should invest or lend money on such properties.

Q. Yes, it would be improved no doubt from the standpoint of the developer who had the green light, as it were, from the authorities to go ahead and either build or sell, build on or sell subdivision lots?

A. Yes."

British Mortgage & Trust, as has been seen, was, under Wilfrid Gregory's guidance, at this time moving into the field of temporary financing of sub-division developers and, as the Registrar said, it was not alone. A further, and, from his point of view, profitless exchange took place between Allen and Gregory at the end of March as to the desirability of making temporary construction loans and then the Chief Examiner, Ernest Dodd, wrote to Gregory on April 8:

"Our examiner, Mr. Allen has been questioning certain investments made by the British Mortgage and, when he received your letter of March 27th he turned the entire matter over to me.

I believe that Mr. Allen has, more or less, expressed the view of this Department. In order to confirm our position, I took the matter to the Registrar and the following interpretation is the result of our meeting.

Improved Real Estate—Land may be considered as improved real estate if it is situated in a built up urban area and is fully serviced with road, water and sewage facilities.

Sub-divisions and other properties not falling within the definition of the above are to be valued at the current value of farm property and the company would be limited in making a loan of $66\frac{2}{3}\%$ of such value. Any amount loaned in excess of such valuation would be treated as a non-admitted asset, however, if the company had made such loans up to the present time, we would permit a special reserve to be established to cover such excess. This reserve could not be taken into consideration when determining the limits on amounts held as Guaranteed Investment Receipts etc. of the company.

There has been no decision made up to the present time regarding other temporary builders loans but you should bear in mind Section 123(5) of the Act which limits the advancement of funds on other than first mortgages to 5% of the total mortgage portfolio. The company would be relegated to a second mortgage position, whenever the final first mortgagee advanced any money upon the security of the property in question."

Gregory replied promptly and at length two days later:

"I have your letter of April 8th. I think it would be wise if I were to have a meeting with you and Mr. Richards to discuss the interpretation of 'improved real estate.' It is apparent that the Department's view does not coincide with my own.

You suggest that land may be considered as 'improved real estate' 'if it is situated in a built up urban area and is fully serviced with road, water and sewage facilities'. I presume that the word 'only' is implied and that no other land can be included in your definition.

Under this narrow interpretation it means that it is impossible for a trust or mortgage company to assist a builder or developer in preparing a sub-division for the erection of homes. As you realize, there is a great deal of work to be done between the stage of raw land and the stage when sites are ready for home construction. This takes a lot of time, money and hard work while the developer is going through lengthy legal procedures as well as installing the basic services such as roads, sewers, etc. To make possible this very important prerequisite to home building, a good deal of money is necessary. I feel that Loan and Trust Companies should be prepared to play some role in this development.

Our own policy has been to take on a few carefully selected sub-divisions after a plan of sub-division has been registered. The valuation is consequently based on about one-third of a market value for lots which have been completely serviced. The money is then advanced to pay for the services so that by the time our total principal is paid, we have a sub-division completely serviced and ready for home building.

I will admit that this is more risky than investing in N.H.A. mortgages and we get a rate of interest commensurate with the risk. A careful and continued scrutiny is kept on these loans at all times. So far we have had excellent success with them."

The remainder of the letter, which is a long one, elaborates the position taken but also includes a refutation of the Chief Examiner's assertion that "the company would be relegated to a second mortgage position whenever the final first mortgagee advanced any money upon the security of the property in question." Gregory averred that British Mortgage & Trust never took a position as second mortgagee under these circumstances, but was paid off from the funds advanced by the "permanent mortgagee". After receiving this reply neither the Chief Examiner nor Allen returned to the charge, and the suggested meeting did not take place. It seems clear that on this third point Gregory successfully maintained his view although the controversy had produced an internal memorandum from the Chief Examiner to the Registrar, dated March 28, drawing the attention of the latter to the correspondence thus far, and saying:

"Attached is the reply which I cannot accept as being a reasonable argument. We have also written to the Company in the interim suggesting that they should not be engaged in temporary Builders' Loans which they advertised in a Toronto newspaper last weekend.

With the increase in funds being made available to Trust Companies they are looking for investment opportunities and when they fall back on such questionable investments I believe that it is time to call a halt."

There the various subjects raised in the correspondence quoted rested until consideration of the annual statement of 1963 was undertaken in the early months of 1964. It will be observed that the officers of the Registrar's department were wrestling with an antagonist who

would not listen to their exhortations as to what was proper and prudent for a trust company to invest in, and who was insisting on the utmost latitude consistent with a strict interpretation of the statute. It seems that Wilfrid Gregory's views came as a surprise to them, in that the majority of trust companies had deferred to the opinions of the Registrar who was a Fellow of the Institute of Chartered Accountants of Ontario and had thirty years' experience of scrutinizing their affairs. It may also be observed that the Registrar, although equipped with powerful sanctions for use against recalcitrant companies by the Loan and Trust Corporations Act, was unable to use them in cases where its provisions were in doubt, or where his own views were in advance of what the Act provided, even had he been prepared to take the drastic and irremediable step of suspending or cancelling the registration of British Mortgage & Trust. He testified that no decision was taken, or any policy adopted, as a result of the arguments with Gregory in 1963, because "there was still a dispute that had not been resolved," although the 1963 annual statement "did show an accentuation of the items which had been criticized in the past" and "the investments seemed to be getting more and more speculative than they had been earlier, and that they would be more and more concentrated".

The Annual Statement of 1963

The annual statement of British Mortgage & Trust Company for 1963 was received at the Registrar's office on February 27, 1964¹ and given immediate attention, for on March 3 another examiner, F. E. A. Jackson, wrote the following letter:

"Dear Mr. Gregory:

A number of queries have arisen on examination of the Annual Return for 1963.

Section 142 of The Loan and Trust Corporations Act limits investments to 15% of Capital and Reserves of \$4,320,000 or \$648,000. It would appear a number of investments exceed this amount. Your comments would be appreciated.

The list of Real Estate held for Sale on page 17 shows properties which have a cost in excess of market value. As the amount which may be advanced on a property is 66⅔% of its value, would you please provide an analysis of the cost of each property held for sale.

Would you please advise where the Real Estate reserves of \$62,-689.81, shown on page 38, is applied. Page 16 shows Total Book Value of Office Premises as \$2,410,974 and Net total \$1,861,001. Page 17 shows Total Book Value of Real Estate held as \$2,963,849, less Investment Reserve of \$160,000 and Net total \$2,803,849. The Total of Real Estate held for Investment and Sale on the Balance sheet, page 7, is \$2,844,858. Would you please account for the differences in these

¹Exhibit 2561.6.

figures. Would you also please advise of the source of the reserve of \$160,000. It appears columns 6 on pages 16 and 17 are not completed and the figures for the property on 404 Edward Street, Exeter, have been omitted. Would you please advise how the book value of Newfoundland Block, Elliott Lake, was decreased by \$5,084.

Section 137,(1),(k), requires Real Estate held for Investment to be leased. Would you please provide a summary on leases on properties held for investments.

Would you please provide a list of securities held under the Basket Clause, section 140 of the Act, and a list of mortgages on vacant land. It would appear investment in West Heritage Properties Limited and its subsidiaries exceed the limitation of section 142 of the Act.

It appears the restriction of Borrowing Power of $12\frac{1}{2}$ times Capital plus Cash set forth in section 75 of The Loan and Trust Corporations Act has been exceeded. Would you please provide your calculation of the Company's borrowing power.

An early reply to this letter would be appreciated.

As the above matters may be of some interest to your Auditors, a copy of this letter is being sent to them.

Yours faithfully,
'F. E. A. Jackson,'
Examiner."

It appears from this that Jackson was not aware of, or perhaps ignored, the capitulation of the Department in the previous year to Gregory's contention that fixed reserves or allowances for loss should be added to the free or general reserves in the calculation of the total of capital stock and reserves for the purpose of fixing the 15% limitation. This brought a sharp reminder from Gregory in his reply of March 18 and he concluded his letter as follows:

"You quote the restriction of Borrowing Power under section 75 of the Act. We might point out to you that this section applies to loan and loaning land Corporations. It is not applicable to Trust Companies.

You sent copies of your letter to our auditors. They have both been over all these matters in making our audit and were satisfied that everything is in order. There will be no need to keep them advised unless you find something to which objection can be properly taken."

Obviously the writer of these paragraphs was in no mood for underlings, particularly those who had the temerity to send copies of correspondence to his company's auditors. His asperity did not, however, intimidate Jackson who wrote on March 25 asking for detailed information about a number of assets, particularly collateral loans to the Atlantic complex, and ended his letter with the following comment:

"Although section 75 of the Act applies to loan corporations it is a long standing ruling of the Registrar that the restrictions on borrowing powers apply to trust companies as well. Proposed amendments to the Act will incorporate the Registrar's ruling on borrowing powers."

Wilfrid Gregory's answer was delayed because of his absence in Europe and on April 29, after stating his opinion that the question of eligibility of securities pledged against collateral loans did not arise, he said:

"On Page 3 of your letter you refer to a long standing ruling of the Registrar that the restrictions on borrowing powers apply to Trust Companies. At the present time this ruling is without authority. We therefore pay little attention to it. When the Registrar's opinion in this matter is approved by the legislature, we will, of course, conform to it in every respect. Until that time, the question is only academic and there is no need, we submit, to go to the trouble of proving that we happen to fall within his ruling."

No clearer illustration of the now open disagreement between British Mortgage & Trust and the Registrar as to the validity of regulatory policy could possibly be given, and the company's managing director had plainly dug in his heels within the four corners of the Act for another season of epistolary conflict. Again his position was technically correct, as Richards made plain in his testimony.²

"Q. Now, did Section 75 of the Loan and Trust Corporations Act, which limited the borrowing power of a corporation at that time to 12 and ½ times its capital, plus cash, have application to a trust company?

A. No, that only applied to loan companies, that section of the Act. But we had had for a number of years agreements with the trust companies that they would follow the same limitations that we had for loan companies.

Q. Over how many years had that been the understanding?

A. I think that goes back as long as I have been with the Department.

Q. That would be ranging on to thirty years?

A. Yes sir.

Q. And had other companies prior to this time—other trust companies, exceeded the borrowing power?

A. On occasion they had exceeded—in those cases when we brought it to their attention, they would raise additional capital—we had several cases of that kind—in order to bring them back within the limitation."

He added that he had no power to make a "ruling" but that he had never known British Mortgage & Trust prior to this to refuse to abide by the agreement.

Subsection (2) of section 75 was as follows in 1964:

"The total amount borrowed by a corporation on debentures and other securities and by way of deposits shall not exceed an amount equal to the aggregate of its cash on hand or deposited in chartered banks in Canada and of four times the combined amounts of its then unimpaired

²Evidence Volume 120, pp. 16312-3.

paid-in capital and reserve, but the Lieutenant Governor in Council may, on the report of the Registrar and upon such terms and conditions as are prescribed, increase the amount that may be borrowed to a sum not exceeding an amount equal to the aggregate of such cash and of twelve and one-half times the combined amounts of such capital and reserve. R.S.O. 1960, c.222, s.75.”

In 1965 this was amended³ by striking out the words “twelve and one-half” and substituting “fifteen”, to increase the borrowing base of loan companies, and adding a new section 82*a* applicable to trust companies reading thus:

“(1) The total of the sums of money received as deposits under section 80 and for guaranteed investment under section 82 shall not at any time exceed an amount equal to the aggregate of its cash on hand or deposited in chartered banks in Canada and of four times the combined amounts of its then unimpaired paid-in capital and reserve, but the Lieutenant Governor in Council may, on the report of the Registrar and upon such terms and conditions as are prescribed, increase the amount that may be received to a sum not exceeding an amount equal to the aggregate of such cash and fifteen times the combined amounts of such capital and reserve.

(2) In ascertaining the amounts that may be received by a trust company under subsection 1, all loans or advances to its shareholders upon the security of their shares shall be deducted from the amount of the paid-in capital.”

On January 27, 1965, Jackson had sent the following memorandum to J. E. Rupert, the new Chief Examiner:

“Further to my memo to Mr. Richards of May 11, 1964 showing loans to related companies and Mr. Allen’s comments in his memo to Mr. Dodd of January 21, 1963.

The Globe and Mail of January 26, 1965 has an article concerning the purchase of Walter E. Calvert Ltd, by Dale Estate Ltd. for \$1,000,000.

\$500,000 will be provided by a 10 year, 6% mortgage, to Calvert. The balance will be paid in cash, \$400,000 to be provided by a loan from British Mortgage and \$100,000 by bank loan.

The directors of Dale Estate Ltd. are:

W. A. Beatty,
D. R. Annett,
Morris Latchman,
Philip Latchman,

D. M. Dickson,
H. D. Dale,
C. G. King.

D. R. Annett and C. G. King are on the Board of six other companies shown in the May 11, 1964 memo listing questionable loans.

³ 13-14 Elizabeth II, c. 61 s. 1.

BRITISH MORTGAGE & TRUST

At October 31, 1963, British Mortgage had a mortgage loan of \$500,000 to Dale Estate Ltd. outstanding since December 15, 1961 on which no principal repayments had been made. Dale Estates Ltd. has lost money in two of its three years of operation and has not paid a dividend.

The details of investment in Short Term notes \$4,682,000 referred to in the May 11, 1964 memo are:

Atlantic Acceptance Corporation	\$1,250,000*
Aurora Leasing	750,000*
Delta Acceptance	400,000
Granite Investment & Development Ltd.	700,000*
Laurentide Financial	497,000
Union Acceptance	1,085,000
	<u>\$4,682,000</u>

Items marked with * appear to be ineligible investments.

May I take this opportunity to bring to your attention that British Mortgage, at October 31, 1963, showed Capital and Reserve of \$4,300,000.

Loans on ineligible investments referred to in the May 11, 1964 memo and those noted above, total \$5,000,000.

As the company appears to be making further doubtful investments, would you please advise if any action is to be taken.

'F.J.'
Examiner."

This was followed on March 3 by a further memorandum:

"The financial statement for 1964 shows Guaranteed Fund liabilities of \$99,700,000 are 19 times capital and reserves of \$5,300,000.

It appears the adverse conditions noted in reports and memos of the past two years are becoming serious.

I strongly recommend that action be taken on questions raised in these memos."

The Annual Statement of 1964

Jackson's preoccupation with the close relationships of the companies and persons to which collateral loans had been made did not, as Richards admitted, arouse any particular alarm in the Department because, although he agreed that Jackson's concern proved to be well-founded, there was no proof at the time that there was anything more than a coincidental relationship among them. His memoranda were moreover, vitiated by a return to arguments which by then were recognized as untenable under the Act as it stood, and the fact that the secured notes of Atlantic Acceptance and Granite Investment were obviously eligible under its provisions; as to those of Aurora Leasing he turned out to be right, but not because of any enlightenment from British Mortgage & Trust, as will be seen hereafter. On the subject of

the trust company's borrowing, and the stage which the argument had now reached, the Registrar's evidence was as follows:¹

“Q. Now, so far as this nineteen times capital and reserves limitation in respect of guaranteed funds, you would now be back to the old argument about what the reserves were?

A. And also the question in the Act there was no limitation.

Q. Would he be referring to the obligation to have in cash or certain liquid securities twenty per cent?

A. No.

Q. No, obviously he is not?

A. No, this is a total of guaranteed funds.

Q. Yes.

A. At which date there was no statutory limitation.

Q. So Mr. Jackson is really not turning to a breach of the Act, he is calling attention to a matter which he considers to indicate some measure of imprudence?

A. Yes, and also the general agreement—a breach of the general agreement that we had had that the companies would limit their borrowings to the twelve and a half or fifteen times.

Q. Yes, which is still ignored to a great extent?

A. Yes.

Q. Mr. Richards, since we are close to the hour for adjournment and I have left it at an important point, would it be fair to say that now, commencing in this same month as this last memorandum of Mr. Jackson's, action begins to be taken and you personally now enter the lists, is that so?

A. Yes, I think that the 1964 statement showed a real deterioration and possibly real danger.”

All of the memoranda produced by Jackson, the last being on March 15, 1965 directed to the Chief Examiner which was a recapitulation of all the matters dealt with in the earlier correspondence, came to the attention of the Registrar himself and as a result he evidently telephoned Wilfrid Gregory—I say evidently because Richards himself did not remember the conversation—as a personal letter from Gregory dated March 22 would indicate:²

“Dear Mr. Richards:

I appreciated the opportunity of having a telephone conversation with you on Friday afternoon. We discussed at some length some of the investments and loans which have been made by this Company. I did not have any information in front of me, so I was at a bit of a disad-

¹Evidence Volume 120, pp. 16337-8.
²Exhibit 2553.7.

vantage. However, I would be pleased to meet you to go over the report in more detail and to put some flesh and blood on the bare bones of the figures.

With regard to our investments, we have followed a policy recently of concentration. We have sold our common shares in many companies but have increased our holdings in those companies where we can exercise a close degree of influence, e.g., I am a director of Atlantic and Commodore and know what is going on. These companies are well managed and are progressing soundly and rapidly.

Our short term loans are mainly to keep excess money well invested. They are payable on demand or within one year. The loans are doubly secured; both by the credit of the borrower as well as by the 120% security put up as collateral.

Our investments made to various individuals are also safe. Practically every borrower is a millionaire. We have the personal covenant as well as the collateral of marketable security.

The thing that concerns me the most these days with regard to investment policy was mentioned by you, i.e., 75% mortgages. I think these are going to need extraordinary control. We intend to advance as few as possible and to keep our valuations even more conservative. It was too bad that persons in your position could not have exercised more influence on preventing the maximum loan being raised from two-thirds to three-quarters.

With finance changing just as much as everything else, I guess we all have to get used to the idea and keep up with it. Mr. Louis Rasminsky, one of the ablest financial men in Canada, said in the report of the Bank of Canada for 1964, 'business must have the foresight, imagination and initiative to seek out and seize the opportunities that arise in a growing economy and to abandon old methods in favor of new rather than look for increased shelter for traditional methods that have ceased to be competitive.'

I do want to stress, though, that even in periods of change caution is necessary. We try to observe both flexibility within the Act and a maximum of care.

Yours sincerely,
'Wilfrid P. Gregory' "

Richards was not however reassured, particularly since he received a memorandum from Rupert, dated March 29, 1965, and since this was dealt with thoroughly by Mr. Shepherd at an early stage in his examination of the Registrar on May 11, 1967, it is advisable to quote the transcript *in extenso*.³

"Q. This appears to be a detailed survey of the annual return as at 31st October, 1964, which, according to the evidence before this Commission, had been received around the 2nd or 3rd of March, 1965. Do you recall seeing this document?

A. Yes, I must have seen it.

³Evidence Volume 121, pp. 16348-53.

Q. Yes. Now, the memorandum touches all the points which have been argued out with Mr. Gregory in prior years. For example, Item 3, mortgages:

'From a review of the correspondence file, Mr. Gregory takes a very broad view of the term "improved" as it relates to first mortgages on subdivision land and temporary builders loans. This divergence of opinion has not been resolved and, accordingly, the extent of the violation cannot be measured at this time. As Mr. Jackson pointed out, 28 mortgages, totalling \$7,160,000, over one year old, show no payment on principal.

Some reserve is required here.'

What does he mean, 'some reserve is required'?

A. Some investment reserve to take care of business losses.

Q. In addition to any reserves set up in British Mortgage's estate?

A. Yes.

Q. Then, Item 4, Collateral Loans:

'Almost all of the pledged securities appear to be in very questionable companies, and accordingly, the company should be required to substantiate the market values quoted.'

And going on, Item 5, Investment in Short Term Notes:

'Unless these notes are eligible under section 137, 1, h, they will not qualify. Since these notes may be guaranteed by eligible companies, no reserve has been set up. The total of investments (direct and indirect) to companies listed below, indicates substantial holdings in very questionable companies.

These are:

Atlantic Acceptance Corporation	\$3,065,000;
Aurora Leasing	\$1,923,000;
Commodore Business Machines	\$1,268,000;
Dale Estates (including \$400,000	
advanced this year)	\$ 614,000;
Granite Investment and Development	\$ 968,000;
Western Heritage Properties	\$1,357,000;
C-I Credit Corporation	\$ 500,000;
Total	\$9,695,000.

I would recommend that we secure credit ratings from the Retail Credit Company as a first step in evaluating whether or not the investments and loans are eligible.'

Did you agree with his approach to that problem?

A. I don't think the credit ratings were established, whether or not they were legally eligible or not, but I certainly think that I had to take steps to, first of all, to decide whether they were eligible within the meaning of the Act and then take up with the company whether they were prudent and conservative investments.

Q. Yes. And then, on page 3, after referring to the change of accounting, does Mr. Rupert go on:

'In my opinion, the method used in the shareholders' statement to disclose the change to accruing interest, is misleading. Note No. 2 in the Shareholders Balance Sheet is completely inadequate. The Bulletins and Rules and Regulations of the Institute of Chartered Accountants require that a change in method of evaluation be spelled out in full so that any one reading the statement is in a position to assess the change in equity that has occurred. I recommend that the auditors be reported to the Institute. I think it was the duty of the Auditors to point out that had this change not taken place, the Capital and Surplus at October 31, 1964, would have increased by only \$30,000. Funds derived from the sale of shares total \$112,000 and without these funds, there would have been a decrease shown in the capital section of the balance sheet.'

Did you form any opinion on the comment of Mr. Rupert as to whether the note in the balance sheet was adequate?

A. I don't think I did. At that time I think I was more concerned with the position of the companies and the fact that this note—I don't think it really went into that to any extent.

Q. Then, he goes on to say:

'I recommend that a very thorough examination be made of the affairs of this company. Mr. Lumbers and Mr. Allen should be available by April 5, 1965, for this work.'

Have I read that correctly?

A. Yes.

Q. Now, Mr. Lumbers and Mr. Allen did not in fact go to the company in April, 1965 did they?

A. No.

Q. What was the reason why Mr. Lumbers and Mr. Allen did not go?

A. I really can't remember the exact reasons, but I know at that time we were having some difficulties with some other companies, and it quite likely was that they were used on some other examination."

Reference has already been made to the fact that at this time the Registrar only had the Chief Examiner and five others as members of his staff, and these were all he had to assist him in his even more demanding duties as Superintendent of Insurance. In one or the other capacity he was charged in 1965 with the superintendence of 34 trust companies, 19 loan companies, 108 insurance companies, 75 mutual benefit societies, 40 pre-paid hospital plans, 3 investment contract companies, 10 fraternal societies and 65 farm mutual insurance companies; as Registrar of Loan and Trust Corporations the number of companies under his jurisdiction exceeded by a substantial margin the number of those under that of his federal counterpart together with those examined

at Ottawa at the request of other provinces. In May, indeed, he was to obtain four more examiners and new rates of pay which made the positions much more attractive to chartered accountants. But by that time the Chief Examiner was on the point of leaving the department and his successor was not to take up his new duties till July. Nevertheless he took action at once upon the Chief Examiner's memorandum and wrote to Wilfrid Gregory in uncompromising terms.⁴

"April 2nd, 1965

Mr. Wilfrid P. Gregory,
President,
British Mortgage and Trust Company,
Stratford, Ontario.

Dear Mr. Gregory:

Your annual statement as of October 31st, 1964 shows paid in capital and reserve fund of \$5,279,000. On reviewing a number of investments shown in the statement it appears that they exceed the percentages allowed under the Act if this figure is used as a base. It appears therefore, that some portion of your investment reserves are considered to be free reserves which may be added to the reserve fund in calculating the required percentages under the Act. Would you kindly advise me of the basis for the figure that is used and just which investment reserves have been added to the reserve fund to justify the investments made.

In schedule A(2) of the annual statement on page 17 there is shown some \$2,900,000 of real estate held for sale with a market value slightly in excess of this figure. Will you advise the source of the market values shown, since it would appear likely that some investment reserves would be required against this asset. Also in this schedule is shown some million dollars of real estate held for investment and I presume that these properties are held under the provisions of section 137(l)(k) and that they are secured by leases as required by that subsection.

It is also noted that at the present time your company has over \$2 million in second and subsequent mortgages as well as over \$1 million in mortgages under which legal proceedings have been taken. It also appears that there is some \$7 million in 28 mortgages which are over one year old and on which no payments of principal have been received. It would seem that substantial reserves against these mortgages are necessary and I presume that your company can substantiate that the mortgage reserves shown on the balance sheet of some \$900,000 is sufficient for this purpose.

In view of the very large investments in and advances made on the collateral of certain companies, I will need to have some additional information about these companies. It does appear that the shares and securities of Atlantic Acceptance do not come within the eligible investments prescribed by the Act because the shares of this company have not the necessary dividend record.

⁴Exhibit 2553.2.

BRITISH MORTGAGE & TRUST

Substantial sums of money have been loaned on the shares and bonds of Commodore Business Machines and from the information available to us, it appears that there is no real market for these shares or bonds. In fact I notice that you have accepted as collateral 500,000 of the 600,000 issued of the 7% 1975 bonds of this company. In these circumstances it seems that any quotation as a market value for these bonds must be unrealistic. Would you arrange to forward an audited financial statement of this company with an explanation of the eligibility of these securities for collateral loans and the authorization for the investments in this company.

I would also like to have a copy of the latest audited financial statement of Western Heritage Properties and an explanation of how bonds of this company could be considered to have a market value. In particular the collateral loan of \$500,000 to Western Heritage Properties on the security of a \$1 million note of Sherwood Properties which I understand is a wholly owned subsidiary of Western Heritage Properties. We appear to need some justification and some reliable confirmation that there is, in fact, a market for such a note.

Advances on the securities of and investments in the following companies;

Aurora Leasing Corporation
Granite Investment and Development
Delta Acceptance Corporation
Dale Estates
C-I Credit Corporation Ltd.

have been made and I will need confirmation that these are authorized investments and that where collateral loans have been made, there is, in fact, an active market.

A number of these companies appear to be in a type of business in which the British Mortgage is prohibited from doing itself and it does appear that, in fact, your company is largely financing the business of these other companies. This could seem to result in a company indirectly entering into a business which they may not transact directly.

Yours very truly,
'C.R.'

Registrar of Loan and Trust Corporations."

This produced the following reply from Stratford dated April 8:

"Dear Mr. Richards:

We have received your letter of April 2nd. We have put three members of the staff to work on obtaining the information and reports which you desire. These will be forthcoming as soon as the required data can be assembled.

In the meantime, let me assure you that everything is in good condition. Values are conservative. The extensive reserves are not required, as no impairment exists in any particular. All action taken has been

properly authorized and is in accordance with the provisions of the Loan and Trust Corporations Act.

You will be hearing further from us shortly.

Yours sincerely,
 'Wilfrid P. Gregory' "

This letter was followed by two more detailed communications in answer to the questions raised by the Registrar, the first of which was dated April 15.⁵

"Further to my letter of April 8th, I can now reply to the first three paragraphs of your letter of April 2nd.

The base which we use for computing the 'capital and reserve funds', which is the basis for several ratios under the Act, is set out for the years 1962-3-4 in appendix 1. This method of computation was accepted in 1963 for the '62 figures and again last year. It was based on the figures of capital and reserves as reported to you in our annual statement, and supported by an opinion both from our lawyers and from our auditors. We do not make any attempt to take into account the excess of market value over book value on investments which amounts to some \$1,750,000.

Your second paragraph asked for information with regard to our real estate held for sale. These values were set by our own appraisers. We felt that if their work was satisfactory for mortgages, it would be for the real estate we own. On the whole, they are conservative. In appendix 2, I have given some detailed information including what has happened since the end of the year. It appears that there is only one property which we should write down for the sake of caution because two stores have not yet been rented. This is the shopping plaza in St. Catharines which we will reduce to \$700,000. I think you will agree that on the whole the market values of the remaining properties are at least equivalent to book value.

The real estate held for investment is strictly in accord with the provisions of section 137-l(k) and secured by the proper leases except for five houses leased to our managers and one business property we were going to use for a location in Newmarket. This business property has now been sold and two of the houses used by our managers are up for sale. We will try to convert the three remaining ones into a mortgage situation within a year. Last year we carried these properties under our business properties account, but one of your inspectors suggested that we handle them this way. I am not sure why. You will note that there is a depreciation reserve of over \$90,000 available for real estate held for investment and sale, which has not been taken into account in computing other reserves.

The \$2,000,000 in second and subsequent mortgages were all excellent investments. Our mortgages plus any prior liens are not over two-thirds of value. They look pretty good compared with the applica-

tions for 75% loans which we are now being asked to take. Unfortunately, over one-half of a million dollars has been paid off this year and we will not be able to get any more.

The forty-eight mortgages on which legal action was taken is as long as it is because of the fact that we included everything in our solicitors' hands. As soon as the mortgage is in default of the second monthly payment, it is immediately sent to our solicitors for collection. All are included in this list. Appendix 3 sets out the detail in every instance and what has transpired. There is no real problem with any of them. This does not seem to be an excessive number to be in default out of about three thousand five hundred mortgages; although we would prefer not to have any.

We have now been going all afternoon and I have not finished the appendix for the last part of your third paragraph. I will send this along on Tuesday, April 20th.

Yours sincerely,
'Wilfrid P. Gregory' "

Appendix 1 consisted of a calculation of the capital stock and reserves and 15% thereof for the years 1962, 1963 and 1964, including the mortgage and investment reserves the addition of which had been conceded by the examiners in the case of British Mortgage & Trust. Appendix 2 contained details of the real estate held for sale and Appendix 3 details of the 48 mortgages in default and of the action taken by the trust company in respect to each. Then, on April 20, Gregory wrote again.⁶

"Dear Mr. Richards:

Further to my letter of April 15th, I will now deal with the statement in your letter of April 2nd, 'It also appears that there is some \$7 million in 28 mortgages which are over one year old and on which no payments of principal have been received.' Then you suggest that substantial reserves against these and other mortgages are necessary. May I assure you, first of all, that you will find there is no need to think about reserves being necessary against any of these mortgages. All of the ones to which you refer which have not had principal payments, were conservatively valued and were not in default."

The letter then continues with some detailed explanation and concludes as follows:

"We trust that these rather lengthy explanations serve to reassure you that there are no problems with these mortgages despite the fact that reduction of the principal does not start as quickly as might be expected. If there are any individual cases for which you would like an explanation, we shall be only too pleased to give it.

I still have some further reports to get with regard to some of the investments. I shall try to have a reply with respect to that aspect of your letter for you within a week.

Yours very truly,
'Wilfrid P. Gregory' "

⁶Exhibit 2553.3.

The final letter in this series of detailed replies was written on April 27. It is a long letter with appendices, and at this point need only be quoted in part.

"My letter of April 20th concluded the information I was to give to you about mortgage and real estate investments. In this letter, I am going to reply to your letter of April 2nd about other investments, starting at the bottom of page one.

I agree that the common shares of Atlantic Acceptance do not qualify as an eligible investment. However, the preferred shares do so qualify. This is not only so under my interpretation of the Act, but the Company obtained a ruling from Osler, Hoskin and Harcourt to this effect. If you would like to have a copy of that, I would be glad to get it for you, but your department accepted the qualification of the preferred shares a couple of years ago.

Contrary to the information given to you, there exists a very good market for the shares and some bonds of Commodore Business Machines. The shares themselves are listed on the Canadian Stock Exchange and closed last Friday at \$10.50 (see Appendix A for stock quotations). From 20,000 to 40,000 shares trade each month. These shares are going to be listed on the Toronto Stock Exchange as soon as the next annual statement is available after the June 30th year end. The 1974 debentures are quoted in the regular bond listings under 'convertible issues'. Because of the conversion privilege, both this issue and the ones due in '75 & 6 are much above par. I am afraid that I cannot subscribe to your conclusion 'that any quotation as a market value for these bonds must be unrealistic'. The fact that an issue is tightly held gives better control of the market and often results in a more saleable commodity than otherwise.

Nevertheless, I am prepared to concede, despite the soaring prices of these securities, that we would be in a sounder position if we did not have as high a percentage, although there is no legal reason for us not to do so. Therefore, I have asked the wealthy owners of some of these debentures to borrow the money elsewhere, which they can easily do at a lower rate of interest, and pay off most of these loans.

I enclose herewith an audited financial statement of the Company for the year ended January 30th, 1964, as well as a six months statement for the period ended December 31st, 1964. Commodore debentures are eligible for collateral security under Section 139(4)(b). The common shares are held under our 'basket' clause.

I have not yet received the 1964 financial statement for Western Heritage Properties. As soon as I get it, I will forward it to you. I do enclose the 1964 annual report for Great Northern Capital Corporation Limited, which controls Western Heritage as well as Atlantic. On page four you will see some general comments about Western Heritage. The bonds of this Company are quoted in the regular bond list under the convertible issues (see Appendix A). Western Heritage is quoted at \$108-\$113. The common shares are quoted on the Vancouver Stock Exchange and will shortly be listed on the Toronto Stock Exchange.

In the ordinary sense, there is no 'market' for the note of Sherwood Properties and that is why there is such a wide margin between the \$500,000 loan and the \$1,000,000 face value. The 'market value' could not be less than \$900,000, whereas a 20% coverage is all that is required by the section above quoted.

I will now deal with the five companies you mention in the second last paragraph of your letter.

AURORA LEASING. We own 22,500 common shares of this Company at a cost of about \$3.33 per share. The present market value is \$4.50 bid. The Company earned about 60¢ a share last year and is paying a dividend of 24¢ a year. The 1964 annual report will be forwarded as soon as received. It is carried in our basket clause.

The loans to Aurora are short term loans based on secured notes of the Company. The security under these notes is at least 125% of the amount owing. There are other holders of similar secured notes but there have not been enough available to build up a wide clientele. We are very pleased to have them available as an investment at 7% involving as it does the double security of the specific asset as well as the credit of the Company."

There followed details of other companies to which loans had been made and two further paragraphs should be quoted.

"You state in your second last paragraph that you wish confirmation that where collateral loans were made there is in fact an 'active market'. I am puzzled at this request because there is no place where the Act requires such a criterion. Section 139(4)(b) provides that the 'market value' of the security must exceed the amount of the loan by at least 20% of the 'market value'. Market value is not defined in the Act, but it is used in your form of annual statement. It is defined as 'the current realizable value'. This, of course, is a proper and long accepted understanding of the phrase 'market value'. This is the test that I have applied to my lending under the said Section 139 (4) (b).

It is rather difficult to reply to your last paragraph because I do not entirely understand its connotation. British Mortgage & Trust Company invests only as permitted by the Loan and Trust Corporations Act. Investments tend to become concentrated because of personal relationships as well as ability to keep an eye on and influence the progress of a company in which we have invested. I do not consider that it is accurate to say the result is that we are 'indirectly entering into a business which' we 'may not transact directly'. We are carrying on only the business of a trust company. We do not make small loans, although York and District Trust do so. We do not sell mutual funds or investment funds, although many other trust companies do so. No type of business in which we have invested is carried on through any of our offices."

There the correspondence ended. The Registrar's department turned to the problem of deciding the question of the eligibility of Atlantic Acceptance shares and notes and entered into correspondence with the Department of Insurance in Ottawa on this question. Richards said that since Rupert, the Chief Examiner, was leaving in June and was to be replaced early in July by Mr. S. Silver he proposed to assign, as the latter's first task, the problem of bringing British Mortgage & Trust into line with other trust companies. His own reaction to Gregory's replies was that they showed a very legalistic approach, although, as he said, he had known for some time that Gregory was in the van of the trust company managers who felt that the limitations on lending and borrowing in the Loan and Trust Corporations Act should be relaxed. From his evidence, and from notes that were made in his own handwriting on Gregory's letters, it appears that his principal concern was for the provision of reserves by British Mortgage & Trust against the real estate held for sale, the appraisal of which, made by the company's own valuers, appeared to be questionable, and against mortgages in arrears or on which legal action had been taken. The effect of setting up such reserves would, of course, have reduced the aggregate of capital and reserves which determined the limit of investment and the issue was critical. Finally, with regard to the company's large holdings of Commodore Business Machines debentures and Aurora Leasing notes, the Registrar gave the following answers to counsel's questions:⁷

"Q. Then, Mr. Gregory writes again, on the 27th of April, in which he deals with many matters in the course of a lengthy letter; and you will observe, on page 1, Mr. Richards, when he is dealing with your suggestion that the market value for the Commodore Business Machines debentures cannot be relied upon, he says:

'I am afraid that I cannot subscribe to your conclusion "that any quotation as a market value for these bonds must be unrealistic". The fact that an issue is tightly held gives better control of the market and often results in a more saleable commodity than otherwise.'

I would like to explore these conflicting views. Why did you consider that if British Mortgage held \$500,000 worth of the \$600,000 issue, one could not rely on the published market price of unlisted debentures—'unlisted' so far as the Toronto Stock Exchange was concerned with respect to the common shares—and that the quoted market value in the newspaper would be unrealistic?

A. Well, I think when one company owns five-sixths of a particular issue on the bond that it is unlikely that the, an individual quotation would be realistic for a \$500,000—\$500—\$500,000 of those bonds.

THE COMMISSIONER: You are thinking of the liquidation aspect of it, if necessary?

⁷Evidence Volume 121, pp. 16372-7.

A. Yes, if necessary. If we had found that these were not authorized investments, we would have required the company to get rid of them to sell them, and the market value as shown in the papers would surely not hold for \$500,000.

MR. SHEPHERD: I suppose the only way which you could get the company to sell these bonds was to use moral persuasion because the company had adopted the device of lending the money to buy these bonds to Mr. Tramiel, Kapp, Wagman and others and had taken the bonds as collateral. There was no prohibition against that course in the Act?

A. This was—oh yes, this was collateral, yes.

Q. Yes?

A. Well, we could have had—got those loans repaid probably or insisting on the company calling those loans.

Q. Yes?

A. Then it would be up to the individual as to how he would raise the money to pay it.

Q. I wanted to ask you about that. Mr. Gregory said something to the effect that as a result of your intervention in April, he re-examined those collateral loans and he decided to call them, and indeed, he did write letters I believe in June, calling some of the collateral loans and he said that he had orally asked for them to be repaid earlier, but unfortunately none of them were repaid prior to the collapse?

A. Yes.

Q. Do you recall any discussion about that or is he referring only to the correspondence?

A. I don't recall any discussion, no.

Q. Then he says on page 2:

'Nevertheless, I am prepared to concede, despite the soaring prices of these securities, that we would be in a sounder position if we did not have as high a percentage, although there is no legal reason for us not to do so. Therefore, I have asked the wealthy owners of some of these debentures to borrow the money elsewhere, which they can easily do at a lower rate of interest, and pay off most of these loans.'

Beside that are a, on my copy at least, a mark, a line drawn in pencil. Would that have been drawn by you?

A. There is not a line on here.

Q. I see. Perhaps it is just one on my copy.

A. Yes.

Q. Would it be fair to suggest to you that you would not be very much impressed with that paragraph?

A. Well, I was certainly glad to see that he was considering getting some of those loans repaid.

Q. Yes, but the wealthy owners of the debentures?

A. Oh.

Q. Who were said to be able to borrow elsewhere at a lower rate of interest presumably neither became nor would remain wealthy by borrowing in places where the rate of interest was higher?

A. No, it would seem a little odd that they would be borrowing it at a higher rate of interest than they needed to pay.

Q. Then, when he deals with the loans to Aurora on page 3, he says:

'The loans to Aurora are short term loans based on secured notes of the Company. The security under these notes is at least 125% of the amount owing. There are other holders of similar secured notes but there have not been enough available to build up a wide clientele. We are very pleased to have them available as an investment at 7% involving as it does the double security of the specific asset as well as the credit of the Company.'

On reading that paragraph, can you say what your belief was to the nature of those investments?

A. No, I can't. He says that they were secured by security and at that time, I didn't know whether they were or not, but I—if he said so, I would at that time, would have assumed that he had some security on them.

Q. Yes, I take it that it did not occur to you that the statement could be untrue?

A. No."

This correspondence, and the evidence given by the Registrar to the Commission during two days, have been examined at length because of their importance in illustrating the administrative problems with which he had to deal and the extent to which he and his officers were hampered by the provisions, or lack of them, in the Loan and Trust Corporations Act. As Superintendent of Insurance and Registrar of Loan and Trust Corporations, Richards was one of the most senior officers of the Department of the Attorney General which in those days was responsible for administering the Insurance Act, the Loan and Trust Corporations Act and numerous other statutes, the responsibility for which has now been assumed by the recently created Department of Financial and Commercial Affairs. In accordance with long-standing custom the Registrar had direct access to the Attorney General himself, unlike the Chairman of the Ontario Securities Commission who reported to the Deputy Attorney General. The dispute with Wilfrid Gregory, although serious and revealing an attitude upon Gregory's part hostile to principles of regulation upon which Richards and his predecessors had relied for many years,

could not, by any fair interpretation of the correspondence reviewed above, be regarded in the spring of 1965 as of sufficient consequence to invoke the Registrar's power of suspending or cancelling the registration of British Mortgage & Trust, a decision which, whatever the provisions of the Act might say, would not have been taken without reference to the political head of the Department. Gregory's replies to Richards' letter of April 2, while intransigent in some respects, were on the whole conciliatory in tone. The need for careful examination of the facts and negotiations of a delicate nature was quite apparent, but there was clearly no occasion for the belief, by an experienced and highly qualified administrator, that the problem could not be solved in the course of the summer of 1965. But all these hopes and calculations were dissipated by the collapse of Atlantic Acceptance in the middle of June. It is now necessary to examine its effect upon the affairs of British Mortgage & Trust Company.

* * *

The Atlantic Collapse and the Reaction of W. P. Gregory

The company's managing director heard the news of the default of Atlantic Acceptance Corporation in Stratford on Tuesday morning, June 15, from his colleague S. K. Ireland and thereupon called C. P. Morgan on the telephone. The latter said that he was afraid that there had been a "technical default", that he did not know if anything could be done about it, but that he was already in touch with prospective buyers and other finance companies which had offered help. He did not appear to be concerned, although he thought there might be a temporary drop in the value of the common shares. After this conversation Gregory telephoned to Alan Christie in New York who told him that some support for Atlantic was assured and he thought that the difficulty could be overcome. Gregory said in his testimony to the Commission that, after these two conversations, he did not think the situation was desperate. He then took a somewhat puzzling step, about which he should be allowed to speak for himself.¹

"Q. What did you do then respecting your position as director?

A. Was it that day or the next day? I sent in my resignation very shortly.

Q. I think you sent a wire did you not, and I believe it may have been the following day. Did you say, 'I don't know' because . . .

A. I am sorry, I don't know. There was a complicated factor here in connection with the sales in New York on Monday or the—rather, the false purchase orders.

¹Evidence Volume 115, pp. 15598-602.

Q. Yes.

A. For Commodore and Racan—and this doesn't matter—which had bothered me, and then after the Atlantic default I was talking to a Toronto area manager here, Mr. Crate about the thing and he was disturbed about it and he said, 'I think the only thing you can do is to dissociate yourself with these things, and get out' and I called one of my friends in the investment business, checked with him to see what he said. He felt—and he felt, I certainly should with Commodore anyway.

Q. Was that Mr. King?

A. No, no. He is one of our local advisory board. And so, I decided. They then called a directors' meeting for Atlantic the next morning and I decided that they were going to be having a great many meetings of Atlantic. They were going to be in a turmoil down here and I had plenty to do on my own home grounds.

So I just decided to send in my resignation for both companies.

Q. I wonder if we can deal with that in order. Dealing first with the orders that proved to be fraudulent supported by forged cheques for the alleged purchase of securities through the New York brokers which securities included Racan Photocopy and Commodore Business Machines, the evidence is that that particular fraud was worked or attempted to be worked on the morning of the 14th of June, and it was detected by perhaps eleven o'clock in the morning.

When did you hear that such a thing had occurred?

A. Well, I think it was when I read the papers, Tuesday morning, that was the opening of the festival in Stratford that Monday night. In fact that week.

Q. Did you connect that occurrence in any way with Atlantic?

A. No.

Q. Then, in what manner was that occurrence a factor which weighed with you in deciding to resign from Atlantic?

A. No, from Commodore. You see, I had resigned from both of them at the same time.

Q. Yes.

A. And when Mr. Crate called me it was both situations, that he thought I should resign.

Q. Were you surprised to learn of the default of Atlantic?

A. I was especially after being assured that everything was under control just six days before.

Q. You had I take it, from your answer, no reason whatever to believe at that stage, that there was anything discreditable about Atlantic?

A. I did not, and I still thought it was a tremendous company and I thought that Mr. Morgan would not have any trouble in getting support which would enable him to carry on and head off any real problems with his creditors represented by the Montreal Trust.

Q. One of the other directors and I don't recall which one it was, put forward the view that he considered it his duty to remain on as a director even though he was not pleased about the company collapsing. What is your view on that?

A. Well, Mr. Shepherd, that is a very nice point and I have often wondered about it and I had one of our directors tell me that, and here you are at 4:30 in the afternoon and things are in a turmoil, and you have been told by your top operating man in the Toronto area should get off both the companies. You phone somebody else and he says, 'Well maybe you could stay on Atlantic.' And then you know you are going to have a heck of a lot of things to do for Atlantic if you are going to stay on as a director, and if you are going to be any good as a director and what do you do? I don't know. If Atlantic had been in Stratford for instance, I probably would have stayed on, but being down here and me having to dash down here for meetings with Atlantic and going to have to go back and carry on my company, I didn't think it was fair to my prime responsibility, that was British Mortgage.

Q. I take it from what you have said, that you did not have a further conversation with Mr. Morgan informing him in advance of your intention to resign. Is that correct?

A. I may not have. I think—

Q. Go ahead please.

A. I think I wrote him that I was resigning and I think—I thought it was quite a nice letter.

Q. Did you have a conversation with any of the other directors respecting your intention to resign?

A. No."

Had he not then known of anything to the discredit of Atlantic Acceptance, his decision to abandon the ship must have been taken because of acute anxiety about the value of British Mortgage & Trust's holdings of the securities of the Atlantic complex. Under these circumstances one might have expected him to remain on the Atlantic board to play a part in attempting to rescue a company which he, and only he at British Mortgage & Trust, knew could involve his own company in disaster unless superhuman efforts were made to avert it. Counsel raised the subject again in connection with his resignation from the board of Commodore Business Machines.²

"Q. Before resigning from the Commodore Business Machine board, did you have any conversation with Mr. Tramiel?

A. No.

Q. Why did you consider that the act of some person unknown, in lodging false orders to buy shares of some companies including Com-

²Evidence Volume 115, pp. 15605-6.

modore Business Machines, with New York brokers, made it desirable for you to resign from the board of Commodore Business Machines?

A. Well, this is Mr. Crate's analysis. I hadn't thought of it, but he phoned me and said, it was hurting me down here and there are a lot of questions about it from the Toronto managers and so on, and he thought I should resign.

Q. Did he say why?

A. Just because of the general questions attached you know. The press didn't play it that coolly and there were lots of insinuations and innuendoes.

Q. Did you have any reason to believe at that time, that there was anything whatever discreditable about Commodore Business Machines?

A. No. I haven't any reason to believe it now.

Q. Did you get in touch with any other director than Mr. Tramiel?

A. I did not.

Q. You just resigned?

A. Yes.

Q. What reason did you advance?

A. I think there was a letter on file somewhere in which I said, just the general unfortunate publicity, or something, meant that I felt that I could no longer be a director."

The question of Wilfrid Gregory's awareness of his own danger and that of his company at this critical time is perhaps a proper study for psychiatrists. The man who took over the reins in 1957 and held them thereafter with so much self-confidence, who had been described to the investing public as "an aggressive and able lawyer",³ now presented a reassuring countenance to the world. Yet no one knew, or should have known better than he that over \$12,000,000 of his company's funds were invested in the Atlantic complex and the extent of the chasm now yawning beneath his feet. One minor but revealing incident must be mentioned. John R. Anderson Q.C., a close friend of Gregory and his partner in the practice of law from 1950 until the end of 1956, had been a director of British Mortgage & Trust, as already observed, since 1955. For some years he had held 100 of the company's old shares which in 1963 became 2,000 of the new shares with a par value of \$5 each and a price of \$40 on the unlisted market at their peak in the winter of 1963-1964. According to his evidence given to the Commission on May 3, 1967,⁴ he had for some time contemplated increasing his holdings, and Gregory had promised to keep an eye open for any opportunity of purchasing the closely-held stock. Anderson, as soon as

³Exhibit 4337.

⁴Evidence Volume 117.

he had heard about the Atlantic default on Tuesday, June 15, telephoned Gregory in the evening about its possible effect on British Mortgage & Trust and was reassured in emphatic terms that Atlantic Acceptance was "a tremendously strong company", that Gregory had been at a meeting of the directors of Atlantic a few days before, where everything had proved to be in good order, and that "it was all just a simple misunderstanding". Next day, on June 16, Gregory telephoned and advised him that 1,001 shares had to be sold by "people in Toronto", and suggested that a price of \$27.50 might buy them. Again Anderson asked about the effect of the Atlantic default on the trust company's shares. He was told that, although British Mortgage & Trust held substantial amounts of Atlantic securities and there might be a little loss on the common shares, none of the others would be threatened. His own account of the consummation of this transaction, and what followed it, is worth quoting.⁵

"A. . . . At this stage I was just getting ready to go away on an extended holiday, and this was six months after a heart attack and I had been ordered to get out of my busy office. He didn't say who the person was. I have read in the press some reference to Tramiel.

Q. Hugo Oppenheim?

A. Perhaps so. I knew they weren't his. I knew he wouldn't be selling me his.

Q. You having agreed to buy these shares, or having informed him that you would buy them at \$27.50 for 1,001 shares, was there any unseemly delay on the part of the vendor to get in touch with you to effect the sale?

A. No. About half an hour, I would say, a certain brokerage firm in Toronto, a man from that firm, phoned me to confirm the transaction verbally, and said he would send the shares to my bank in to-night's mail with a draft and would I pick them up.

Q. And you did buy them and paid—

A. \$27,527.50.

Q. Then at this point in time, on the information you have, I take it that you are obviously not concerned about capital impairment of British Mortgage?

A. That's right, sir.

Q. Am I correct that there was a directors' meeting at which the matter of the effect, if any, of the Atlantic collapse on British Mortgage was discussed?

A. There were at least two executive meetings rather than directors' in late June before I went away on my holiday. One of these—you see, I bought the shares on June the 17th, so one of these must have been within a few days of that. Your records will show that.

⁵Evidence Volume 117, pp. 16062-6.

Q. You bought them on the 17th of June and there was a meeting on the 23rd, I believe.

A. I see. Well, probably at that one. In any event, Mr. Gregory made reference to the Atlantic collapse, that the situation was being followed very closely and the auditors were in looking into the whole thing and we would have another full report.

Q. That is to say the auditors of British Mortgage?

A. Yes.

Q. Were assessing the extent of British Mortgage's—

A. The extent of damage to us. Then there was another meeting very shortly after that at which I recall Mr. W. H. Gregory, the chairman of the board, said, and these were his words, 'As so often happens in these situations we find there is trouble now with another company, Aurora Leasing.' And this was the first time I thought this thing went deeper than maybe an erosion of a dollar or so a share. 'But we are looking into it thoroughly and the auditors are going in and we will report to you fully when we can.'

I said—I should preface this by saying that a month or so before we had been given verbally the six months report on British Mortgage earnings for the year. That would be as of April 30th. And it was a very optimistic report indeed. I think it said that we had earned almost as much in the six months as we had in the previous year. And so I was relating it in my mind to our earnings for the year rather than our capital. And I asked the question: 'Well, can you give us some indication of what effect all this is likely to have on our earnings statement or our earnings picture for this fiscal year?' I well remember him saying, 'It is entirely premature to ask that. The auditors are looking into it and we will keep you fully advised.'

Q. Did Mr. W. H. Gregory say that?

A. Mr. W. H. Gregory, the chairman of the board.

Q. Then what was the next thing you hear that would confirm you in your view that it was not premature to ask about the effect on British Mortgage?

A. Just within a day or so of that I went on my holiday down to Lake Placid, New York, and on about the 7th of July, in any event it was a Friday, early Friday afternoon, I received a phone call from a brokerage house in Toronto that had nothing whatever to do with British Mortgage, brokers I had used myself, and the man there was telling me of a number of very nasty rumours concerning British Mortgage that were going around the street, and he said to me, 'Are you sure they are not true?' I said to him, 'I am sure they are not true. This is quite impossible.' But he said, just as a friendly matter to me, he felt he should let me know about them and that I should get a hold of Mr. Gregory, or we discussed it that I should get hold of Mr. Wilfrid Gregory and get him into print denying them.

Q. What did you do?

A. We both thought they were deniable, of course, at that time.

Q. What did you do?

A. I promptly phoned to Mr. Wilfrid Gregory and the office said he wasn't in, that he was away for the day. I then asked for Mr. J. M. Armstrong, the assistant general manager, and he was not—well, he was on holidays, so they said, but he wasn't in fact away that day. Then I debated for probably an hour as to whether or not I should speak of these matters to anyone under that senior echelon that I have referred to and I decided that I just couldn't wait longer without speaking to someone, so I phoned to Mr. James R. Anderson, the controller.

I repeated the gist of the conversation from my brokers to him and I said, 'Get hold of Wilfrid Gregory and get something in the press denying these rumours', and he said, 'We can't. They are substantially true.' Then I was alarmed. I said, 'Where is Wilfrid? I have got to talk to him.' He said, 'He and Mr. Armstrong are seeing certain people', and I can name them if you wish, 'in Toronto, seeing certain people with a view to a possible take-over.'

Q. That is the Denison?

A. Yes."

Wilfrid Gregory had already testified about Anderson's purchase of shares.⁶

"MR. SHEPHERD: Mr. Gregory, did you have a conversation with Mr. Anderson the solicitor, on the 17th of June, informing him that whereas he had expressed an interest from time to time in acquiring shares of British Mortgage, that it had come to your notice that there was a block of shares available for sale to the number of a thousand and one, I think was the number?

A. Yes. I suggested to him, wait—first of all, Mr. Rennie Goodfellow called me and said, that Jack Tramiel's shares had to be sold because of the Commodore market fiasco, and he thought before he threw these on the market, that I might know somebody that was interested. So I spoke to John, because I knew that he was interested and we were able to get him what I thought was a very good price at that time, and I think I told him that as far as I could ascertain, that the Atlantic situation was not serious, but it let the—gave an opportunity to buy the shares at 27½ or 28½.

Q. 27½. Was it your impression that Mr. Goodfellow was going to be the broker selling these shares?

A. Well, he phoned. My recollection is, he was—no wait. Maybe I am wrong.

Q. They were lodged with O'Brien, Williams, Mr. Gregory?

A. I am sorry, yes. It was somebody then from O'Brien, Williams. What was his name? Who was their Toronto man. At any rate, he

⁶Evidence Volume 115, pp. 15609-9B.

phoned and I had never met him. I had talked to him I think once before. He may have bought them I don't know, for Jack Tramiel, but he phoned me and said, 'They had to sell these' that is right.

Q. Now, those shares were the property of Hugo Oppenheimbank (Canada) Limited. They had previously been the property of Hugo Oppenheim Berlin.

Were you aware of that?

A. I was not. He talked of them as Jack Tramiel's shares.

Q. Hugo Oppenheim Berlin bought those shares on the open market from a number of vendors in April 1965.

Did Mr. Tramiel have any conversation with you leading to his decision, if it was his decision, to take a position in British Mortgage?

A. No. I think he just told me at one stage, he just commented on either, that he was thinking of it or it was buying some shares and this is why I wasn't surprised when they said, they were Jack Tramiel's shares. Because it was he. He just said, 'I am buying'.

Q. Did Mr. Anderson ask you the effect which the receivership of Atlantic would have on British Mortgage?

A. We discussed that.

Q. And what did you tell him again, please?

A. Well, I told them that as far as I could ascertain that it was just a temporary effect. It couldn't hit us seriously and that the shares were a good value being able to buy them under these circumstances.

I think they were down 4 or 5 dollars from what they had been a week or so before.

Q. My recollection is that they had been trading in the range of 30 to 31.50. Is that your recollection, prior to the collapse of Atlantic?

A. Well, they were higher than that, but it depends where you go. They had been 40 the year before, and they had been all the way up and down.

Q. And Mr. Anderson did in fact buy them?

A. That is correct."

It seems incredible that Gregory would knowingly expose an old friend to the risk of heavy loss rather than make an admission of anxiety, and this event might be regarded as an indication of his complete lack of comprehension as to what was to happen to British Mortgage & Trust, were it not that such an investment, at a time when the situation of Atlantic Acceptance was not yet clarified and in the light of Gregory's special and perhaps unique knowledge of the extent to which the fortunes of British Mortgage & Trust depended upon it, should have appeared strikingly unwise to even the most infatuated optimist.

The Intervention of Harold R. Lawson

That he was neither confident nor entirely uncomprehending is shown by his turning shortly afterwards for advice to a member of his own board whose position and experience were most closely allied to his own, Harold R. Lawson, president of the National Life Assurance Company. Lawson gave his evidence to the Commission on May 9 in 1967,¹ and said that he had received a telephone call from Gregory "within the week after Atlantic defaulted". Gregory was concerned about the rumours which he said were beginning to circulate about the default of Atlantic Acceptance and its relation to the false orders and forged cheques received by stockbrokers in New York. He intimated that these rumours were, to some extent, involving British Mortgage & Trust and Lawson recalled that on this occasion Gregory mentioned his own resignation from the Atlantic board; he said "although Mr. Gregory's tone of voice indicated some concern during this telephone conversation, his words tended to make light of the thing, that this was not important, and that he was disturbed more by the rumours than with any actual difficulties that British Mortgage might be in." He had tried to reassure Gregory because he felt that he was worrying about a matter of very little importance, in that the investment of British Mortgage & Trust in Atlantic Acceptance was small compared to those of many large and important institutional investors. As for himself, he had not heard any of the rumours referred to by Gregory. Then there was another telephone call about this and Lawson's own reaction should be measured by his own words.²

"Q. And then what is the next thing of any significance which happened?

A. Well, he phoned me again—and I can only guess that this may have been a week later, probably not more than a week later, maybe less—and he, he seemed still more concerned than he was before and he said that he was thinking that maybe the company had better seek an opportunity to merge with another trust company, which was a great surprise to me because I had, I had never thought of anything like that before, but he indicated I think that one of the other trust companies, one of the bigger ones, had made overtures to them in the past and that he thought that under the new circumstances that he had better go in and talk to the president or general manager of that company and . . . Would you like to prompt me a bit more?

Q. Yes. What was your reaction to that proposal?

A. Well, it was surprise and concern that I, from any knowledge that I had, I couldn't understand why he was thinking that way. I couldn't—I had no appreciation of the seriousness of the problem.

¹Evidence Volume 119.

²Evidence Volume 119, pp. 16154-9.

Q. Did you direct some questions to him to ascertain why such a surprising proposal would suddenly come out of the blue, as it were?

A. Yes. I am sure I did. I can't remember the words, Mr. Shepherd, but I, I said, 'Well, you have got certain investment in Atlantic shares, and we'll lose something, but that's not that, not that serious and . . .', whether I was aware at that time of these, of these short term notes and so forth, I don't recall definitely.

But, if I can go on—

Q. Yes—

A. —I would say this, that that telephone conversation led me to look up in my files this, the president's report to the annual meeting and I did read the first part of that—

Q. Yes—

A. —of the commentary in the report fairly carefully and it was a very reassuring and gratifying report, that everything was going well, the company's short term indebtedness was up, but that was a matter of trying to keep their money working and so forth; but then when I studied the list of securities, in the light of what I had been reading in the newspaper, and was able to connect Commodore with Atlantic and found out somebody by the name of Powell Morgan was president of Atlantic and he had borrowed money from British Mortgage I could see some interrelationship between these—

Q. Yes. By this time the name Aurora had already had some publicity, had it?

A. I think it had.

THE COMMISSIONER: Mr. Lawson, you said the president's report to the annual meeting. It occurs to me from the way you described it there, that this may have been the managing director's report to the directors. Is that right? This was a document of some—?

A. I am sorry, you are quite correct, sir.

Q. Yes.

A. The president and the managing director were one and the same, but technically you are absolutely correct.

Q. This was not a document, so the evidence indicates, it was not made to the annual meeting—?

A. No. I had a feeling that Mr. Gregory explained to me that this was a confidential document—just available to the board—

MR. SHEPHERD: In the course of your conversation with Mr. Gregory—I am referring to the second phone call when, for the first time, he speaks of a merger or other arrangement with another company—did you direct his attention to the question of whether or not the directors should be called to a meeting before a step of that nature was taken?

A. The chronology of these things is a little hard for me to, you know, recreate. I am quite sure that after studying this list of investments as of, I think October, 1964—

Q. Yes—?

A. —that then I called Mr. Gregory back and asked him, you know, if indeed these things were all connected and whether they still owned the investment in Aurora for example. I don't remember the figures, but I do think that the answer to that was that they had increased the investment since the year end—

Q. Yes—?

A. —and so on the basis of that discussion, why, the whole matter looked to me to be much more serious than he had indicated.

Q. And what did you tell him he should do?

A. I am quite sure that I told him that he should immediately have a meeting of the board of directors, and he replied that there was a regular meeting coming up about a week later and that it would be awkward to call a meeting any sooner than that, because of the necessity to give notice and that it wasn't that urgent and so on. My recollection is that the regular meeting was held towards the end of June, which would be possibly within a week after this telephone conversation.

Q. Would it be fair to say then that now being informed to some extent at least of the amounts involved as at June, 1965, which were very substantially higher than had been the case on the 31st of October, 1964, that you now felt a sense of concern about this matter?

A. Yes, that is true.”

Lawson went early to the regular meeting of the board in Stratford on June 29, with the express purpose of having a preliminary conversation with Wilfrid Gregory. In the course of the discussion they examined the company's investment portfolio together and for the first time Lawson learned that the Aurora Leasing notes were not secured. In answer to Lawson's obvious question as to how it had been possible to place so much confidence in C. P. Morgan and his enterprise, Gregory maintained that his confidence had been well placed and was justifiable at the time. In spite of being assured that what had happened was merely misfortune and would all come right in the end, Lawson was no longer to be deceived as to the possible magnitude of the trust company's loss, or as to who was responsible for it. The first stage of the conversation ended by him suggesting to Gregory that he should resign as president and the latter's refusal to contemplate such a step. But Lawson was by then thoroughly aroused.³

“Q. On what grounds did you put that to him?

³Evidence Volume 119, pp. 16162-6.

A. Well, on the grounds that his management had not turned out well in effect. I think it had been—well, he had made unquestionably, you know, the greatest mistakes in investment judgments and so forth, and I think that the proper thing for him to have done would be to resign and let someone else manage the company.

Q. Up to this time, had there been any suggestion of situations which might have involved a conflict of interest?

A. No, not that I know of.

Q. I take it you were putting this suggestion then, to put it bluntly, on the grounds of incompetency. Is that correct?

A. That is correct, yes, and there was a lot of precedence for that sort of thing. If management fails, why, then it should step aside and be replaced.

Q. Yes. What was Mr. Gregory's reaction to this?

A. Oh, he wouldn't hear of it. He felt that there had really been nothing wrong with his management. It was true that they had run into misfortune in these investments, but he was certainly capable of managing the company. He was capable of extracting the company from its difficulties and he was not inclined at all to resign, and I now remember that another topic of conversation was, whether or not this whole business should be reported to the board of directors.

Q. Yes?

A. And we had quite a discussion about that because the matter was certainly serious enough in my opinion, to bring to the attention of the board and to be disclosed to the board, but Mr. Gregory did not want to mention it to the board.

Q. Did he say why?

A. Well, I think he felt it would only worry the board to hear about these troubles and that they would not be—they would not be in a position to be helpful.

Q. What was your reaction?

A. He must have had the feeling or he indicated the feeling I should say, that everything could be rectified and without too much difficulty and that there was no reason for getting the board upset at that time.

Q. I gain the impression, Mr. Lawson, that at this point in time it would be fair to say that you felt the most profound concern about the position of the company. Is that correct?

A. Indeed I did, yes.

Q. To what extent did Mr. Gregory appear to share your concern?

A. Well, not fully, not fully. I think at that point he still had a great deal of confidence that the situation could be saved without serious loss to the company.

Q. Was he advancing any grounds for that belief?

A. Well, I don't remember specifically. I think I would be trying to rationalize or recreate suggestions.

Q. When Mr. Gregory indicated that he thought it would not be desirable to inform the directors at that stage, what was your reaction to that?

A. Oh, I felt very strongly that he should and I insisted that he should inform the directors.

Q. And what step was taken then, leading to—?

A. He called his father in. His father being chairman of the board.

Q. Yes?

A. And we put our respective cases up to the father. I felt strongly that the board should be notified and given an opportunity to discuss the matter and take appropriate action. I think somewhere along the line there, why, we were beginning to sense the problem of informing the shareholders. Although the need for that became increasingly evident as time went by.

Q. Yes?

A. But certainly the board should be informed, but the president on the other hand, felt that it wasn't necessary to bring it up before the board meeting at this time, and there was no use getting them upset, exposing points that we were putting up to Mr. W. H. Gregory, the chairman.

Q. W. H. Gregory, and what view did he reach?

A. He said, 'I will say something to the board', he didn't discuss it. He was a man of a few words. He said, 'I will report it to the board'.

Q. Then, was that substantially the end of this conversation which took place before the board meeting?

A. Yes. Those were the main subjects covered, but I would say, it was at least a half hour, maybe an hour's discussion and maybe some recriminations in summary."

Lawson was disappointed in the statement that the chairman actually made to the board which was very brief, suggested that the impact of the Atlantic collapse might be more serious than had hitherto been supposed, and ended in an assurance that the company's auditors were examining the matter, and the board in due course would be informed of the result. At that meeting, indeed, a financial committee was appointed, consisting of W. P. Gregory, the assistant general manager J. M. Armstrong and Lawson himself, with power to add to its number and share with the president the responsibility for investment policy which by then appeared to require drastic liquidation of many of the company's assets. Lawson regarded this as "a weak substitute for replacing the president".

In spite of his impassive bearing on this occasion, there is reason to believe that the chairman of the board was more seriously concerned than he allowed himself to appear. A. B. Monteith the company's auditor described his own experience five days before Lawson confronted the Gregorys.⁴

"Q. The evidence before the Commission is to the effect that the interim receiving order in respect of Atlantic Acceptance was made on the 17th of June, 1965, and that a meeting of the executive committee of British Mortgage & Trust was held on the 27th of June at which the chairman of the board made reference to the auditors doing some report or making some survey of British Mortgage's involvement with Atlantic Acceptance. Did you receive from anyone any request to make any examination of that nature?

A. I was called by Mr. W. H. Gregory on the Saturday morning, I believe, preceding that date that you mention.

Q. That would be preceding the 27th of June?

A. I believe so, I think that would be the 24th, probably.

Q. What time of day were you called?

A. This was about eighty-thirty in the morning, I think.

Q. And what did Mr. W. H. Gregory want?

A. He asked me if I would come to his house which is only a matter of two-thirds of a block from where I lived and see him for a short time which I did. He asked me if it would be possible for us to go in on the following Monday and assist the staff of the British Mortgage in compiling a list of their investments. I don't mean mortgages, I mean especially the ones in connection with Atlantic. Try to get values as accurately as we could because I believe the board met on the Tuesday.

Q. Did he say why he was doing this?

A. No he didn't say. He obviously was concerned. He didn't seem to know how deeply the company was involved, how this would affect them.

Q. Did he say that he didn't know?

A. Well now, he didn't say that directly, but he seemed to feel that he would like us to assist him in the preparation of this list, but didn't give the reason.

Q. The internal staff of British Mortgage would, of course, be quite capable of making a list of the investments of the company, would they not?

A. That is true.

⁴Evidence Volume 122, pp. 16502-6.

Q. Do I understand you to say that he did not say why he wanted the auditors to come in?

A. That's right.

Q. Was there any further discussion about this?

A. No.

Q. At that time?

A. I didn't see him after that at all. We did go in on that Monday. We checked the listing. They had had a list, I believe, prepared the previous week. We used that as a draft. There were very minor changes in the week. We got market values from the Globe and Mail for the previous Friday. There of course were some investments which were estimates. We didn't prepare anything that was independent and of course certified nothing.

Q. So there already was a list which the staff had prepared. What he really wanted you to do was go in and check and verify that list.

A. And bring it up to date.

Q. Bring it up to date. Then having done that, what sort of report did you make?

A. We made no report.

Q. Did you make an oral report to anyone?

A. No.

Q. Then what did you do with the list? Just go down it, check it?

A. That's right.

Q. Say 'this is correct'?

A. Didn't sign it. I was just merely assisting, that is how it turned out, just to assist the staff.

Q. And who got the list then, Mr. Anderson?

A. Mr. Anderson.

Q. The comptroller?

A. I presume he turned it over to the board on Tuesday.

Q. Apart from that examination of which you speak, was there any other examination made by yourself or, to your knowledge by Mr. Black after the collapse of Atlantic?

A. None whatsoever.

Q. Nor were you asked to make any?

A. That is true.

Q. There was no report other than—?

A. That is true.

Q. Other than the verification of the list?

A. Well, that wasn't in the report.

Q. You didn't really report?

A. We didn't report."

On this occasion, and on the subject of this step, the chairman did not confide in his son.

The Salvage Operation

Between the meeting of June 29 and the next on July 13 the situation of British Mortgage & Trust deteriorated with alarming rapidity. It will be recalled that John R. Anderson had been advised, in his telephone call from Lake Placid on July 7, that Gregory and Armstrong were seeing certain people in Toronto "with a view to a possible take-over", and on the following day it became known that Denison Mines Limited, the well-known producer of uranium ore, had offered \$6,000,000 for a controlling interest in the trust company's stock. Gregory had consulted the Registrar about this transaction and both of them together had seen the Attorney General for Ontario, the Honourable Arthur Wishart. Richards, by this time fully aware of the threat to the solvency of British Mortgage & Trust, himself visited Stratford and installed his auditors to make a thorough examination of the company's assets and securities. At the same time Peat, Marwick, Mitchell & Co. arrived on the scene to make an examination of their own, in accordance with the terms of the option agreement between British Mortgage and Denison which was reduced to final form and signed by the parties on July 14. The agreement was lengthy and somewhat involved, but in essence provided for the purchase of not less than 300,000 of the unissued shares of British Mortgage & Trust at \$20 per share, and not more than 675,726, or all unissued shares in the treasury, at \$8.8793 per share, permitting Denison to rescind the option, exercisable up to August 20, at any time within seven days after notice of its exercise had been given, if the price per share specified by Denison was less than \$10. Everything depended upon the opinion of Peat, Marwick, Mitchell & Co. who, as they dug deeper into the trust company's affairs, found a price of \$12.50 per share, which had been considered the probable level of acquisition, increasingly difficult to substantiate. But when the announcement of Denison's offer to acquire control of "faltering British Mortgage & Trust Company" was made in the press on July 8, the stock, which had declined on the unlisted market from the price of about \$32, immediately before the Atlantic default, to \$27 at the beginning of July, suddenly fell overnight to \$8 bid and \$10 asked on

July 9. At the same time panic developed in Stratford, unallayed by reassuring reports from the company's president reported in the local press. Head office and branch offices alike were besieged by depositors who, in the next three weeks, withdrew approximately \$10,600,000 of deposits payable on demand out of a total of approximately \$34,260,000 held at the beginning of the month.

As a result of this development the Denison Mines option, approved by the directors of British Mortgage & Trust on July 13, ceased to be of practical importance and the question of liquidity, to meet depositors' demands and to protect the guaranteed funds of the company, became the principal concern of directors and government officials alike. The habit of years, which had prescribed brief and formal directors' meetings, was broken on July 13 when Lawson insisted on a thorough discussion of the company's investments and the reasons for the involvement in the Atlantic catastrophe. At the same time he took the lead in attempts to secure assistance from the chartered banks and the Trust Companies Association of Canada. The banks, not surprisingly in view of their position as competitors, were unsympathetic, and Lawson was afterwards to speak bitterly in public about the reception of himself and Gregory by the Trust Companies Association. He said that there was a great deal of discussion but nothing was accomplished. One incident which caused him concern, and which may have had its effect, was described in his evidence.¹

"MR. SHEPHERD: Did Mr. Gregory attend either of the meetings with the trust company association? W. P. Gregory?

A. Yes, he definitely attended the second meeting; I don't recall that he attended the first meeting.

Q. Was he in the meeting itself throughout its progress?

A. No, no, he waited in an ante-room during the first part of the meeting and was subsequently invited into the meeting.

Q. Did any matter arise affecting Mr. Gregory at this second meeting?

A. Well, it all affected him in a sense, but there was—the question arose as to what degree of ownership he himself had in Aurora Leasing.

Q. And what was that discussion?

A. Mr. Gregory had indicated to someone somehow—I have forgotten exactly how—that he had a 5% interest in the capital of Aurora Leasing.

Q. Yes?

A. Whether I was aware of that at the time this meeting started or not, I honestly just don't remember for certain, but one of the members at the meeting indicated that Mr. Gregory had made the statement that he had

¹Evidence Volume 119, pp. 16173-5.

a 5% interest, but this individual at the meeting had seen the shareholders' list of Aurora and there was evidence that Mr. Gregory's holding exceeded the 5%. I think that it was more like 18%.

Q. What occurred then?

A. Well, I remember taking the position myself that if he said he had 5%, that he must have 5%, that there must be something wrong with the record. But when Mr. Gregory came into the meeting later he was challenged on this point and the chairman asked him what percentage ownership he did have in Aurora, and he said—I must be careful; those may not be the words, but the implication, as we understood the question, is what percentage ownership he had in Aurora. He said 5%. Well, then, this record indicating a larger ownership was produced, and Mr. Gregory said—well he had meant that he had taken up 5% in the first instance but he had become entitled to certain conversion options or something since, and that his ownership had got up to the level indicated.

Q. Was that the first occasion, so far as you can now recall on the confused events which must have been occurring daily after the beginning of July—was this the first occasion in which you had any reason to doubt the accuracy of everything you were being told?

A. Yes, I would say definitely it was the first occasion, and I wouldn't like for the moment to suggest that there were any other occasions except by, you know, by rumour or something."

Although the Denison option was never taken up, it was clear, from the time when this proposal to inject \$6,000,000 of new capital into British Mortgage & Trust first became known, that the company's capital was so impaired by losses resulting from the collapse of Atlantic Acceptance as to prevent it carrying on without assistance. The negotiations with Denison were the last in which W. P. Gregory took an active part as president and managing director. He testified that his fellow directors had lost confidence in him and that he had lost confidence in himself. Still, however, there was no offer to resign. John R. Anderson described the situation to the Commission in moving terms.²

"Q. As of approximately what date do you say that W. P. Gregory ceased, as a practical matter, to be the principal operating officer of that company?

A. Very difficult to pin that to an exact date. I would say he had been just that up to the time that I returned. When I returned on the Sunday night and the Monday, to which I refer, and there were directors' meetings then on the Monday and the Tuesday and almost continuously during that week, he was still in name the president and general manager.

Q. Yes.

²Evidence Volume 117, pp. 16076-8.

A. But of course our confidence had been entirely shaken, and I would say that to a large extent the direction of the company was taken out of his hands right then and there as of that time, in fact officially a week or two later.

Q. Which of the directors would you say thereafter took the lead, as it were?

A. Oh, I would say from the beginning that Mr. Lawson took the lead in the directors' part of it. Mr. Armstrong played a very active part. I played a fairly active part myself, not in the administration, but I remember on the Tuesday, I am sure was the date, that solicitors for Denison were up discussing a possible deal with them, and I took a pretty active part in that.

Q. Yes?

A. I don't want to give the picture that I ran the company in the next few weeks.

Q. No, no.

A. But we all did.

Q. What explanation, if any, did Mr. W. P. Gregory give as to how it was that this company found itself in the position in which it did find itself?

A. Oh, I must say that I for one, and I think the rest, did not really press him for explanations. The situation was so tragic and so grave and moving so fast because of the run on the bank, that our hands were full in trying to keep the ship afloat, if I may use that analogy. Mr. W. P. Gregory was so physically and mentally and nervously affected by it all, I would say, at that time, that we out of kindness did not press him for explanations of how we had got there.

Q. What explanation did Mr. W. H. Gregory offer or what comment did he offer?

A. Really I think the same answer applies, sir. I don't remember any comment that I can attribute to his mouth."

The Merger with Victoria and Grey Trust Company

The directors who for so many years had implicit confidence in the management by the Gregorys, father and son, of British Mortgage & Trust, which as Anderson said, was regarded as a "monument to them", were not emotionally capable of taking the radical and distasteful steps necessary to save the company from insolvency. Harold Lawson, with the powerful assistance of Senator M. Wallace McCutcheon, chairman of the board of the National Life Assurance Company, took over practical control of the trust company's affairs. Both men were substantial shareholders, the latter through investment by Gormley Investments Limited, a family holding company, and between them held some 14,000

shares. In the course of these desperate days in July it became obvious that the only practical solution was a merger with another trust company and that the only one interested was Victoria and Grey Trust Company of Lindsay, Ontario, which had a history and record of development in rural Ontario similar to that of British Mortgage & Trust. Victoria and Grey let it be known that, provided their auditors could substantiate the value of British Mortgage & Trust assets, its board of directors would consider recommending to its shareholders a merger of the two companies, based on an exchange of six shares of British Mortgage & Trust for one of Victoria and Grey. The result would be to establish a market value of \$2.50 for each share of British Mortgage & Trust, or less than a tenth of that which prevailed immediately prior to the default of Atlantic Acceptance Corporation.

At the regular meeting of the board of directors of British Mortgage & Trust, held on July 20 according to the minutes,¹ Wilfrid Gregory applied for and was granted permission to be relieved of his managerial duties which were assumed by A. V. Crate. But, according to Lawson, Victoria and Grey would not deal with Gregory in any future negotiations and considered that he should no longer be president. In consequence, at a special meeting of the British Mortgage board called by the chairman on July 27, he resigned as president and managing director and left the meeting forthwith. Lawson was unanimously elected as his successor, with the title of president and chief executive officer of the company, and thereupon appointed Crate as general manager and Senator McCutcheon as general counsel. The minute of the main purpose of this special meeting was recorded as follows:²

**“AMALGAMATION AGREEMENT—VICTORIA-GREY AND
BRITISH MORTGAGE:**

The Chairman of the Board spoke to the Directors about negotiations with Victoria-Grey and then asked Senator McCutcheon to explain the Agreement. Senator McCutcheon went through the Agreement in detail explaining the pertinent points and the end effect if approved by Directors and Shareholders. The Agreement was approved by Victoria-Grey Directors and executed by the officers of Victoria-Grey on July 26, 1965. He also referred to the existing option held by Denison Mines Limited which is effective until August 20, 1965.

After a lengthy discussion during which it was specifically pointed out that the alternative to approving the Agreement was to have the Department of Insurance close the doors, the Chairman polled Directors individually and execution of the Agreement in the form attached hereto was unanimously approved.”

¹Exhibit 111.

²Exhibit 111, p. 318.

BRITISH MORTGAGE & TRUST

The agreement thus approved is reproduced below.

"THIS AGREEMENT made the 27th day of July, 1965,
BETWEEN:

VICTORIA AND GREY TRUST COMPANY
(hereinafter called 'Victoria')

OF THE FIRST PART,

— and —

BRITISH MORTGAGE & TRUST COMPANY
(hereinafter called 'British')

OF THE SECOND PART.

WHEREAS Victoria and British are incorporated and constituted as trust companies under the Loan and Trust Corporations Act, R.S.O. 1960, Chapter 222, and amendments thereto, having the same or similar objects within the scope of the said Act and acting on the authority contained therein have agreed to amalgamate upon the terms and subject to the conditions hereinafter set out;

AND WHEREAS the authorized capital of Victoria is divided into 1,750,000 shares of the par value of \$2.00 each of which there are at the date hereof 1,340,350 shares issued and outstanding and fully paid;

AND WHEREAS the authorized capital of British is divided into 1,000,000 shares of the par value of \$5.00 each of which there are at the date hereof 304,274 shares issued and outstanding and fully paid;

AND WHEREAS Victoria and British have each made full disclosure to the other of all their respective assets and liabilities;

AND WHEREAS it is desirable in the interests of Victoria, British and their respective shareholders that such amalgamation should be effected on the terms and conditions of this joint agreement entered into for that purpose.

NOW THEREFORE subject to the elimination or cancellation of any outstanding options to buy shares of British THIS INDENTURE WITNESSETH as follows:

1. VICTORIA and BRITISH agree to amalgamate and do hereby amalgamate under the provisions of the Loan and Trust Corporations Act of the Province of Ontario to form one corporation under the terms and conditions hereinafter set out, the corporation formed by the amalgamation being hereinafter for convenience referred to as 'the Amalgamated Company'.
2. THE NAME of the Amalgamated Company shall be 'Victoria and Grey Trust Company' and its purposes and objects shall be to carry on the business of a trust company in all its phases and departments with all the powers and privileges of a Trust Company within the meaning of the Loan and Trust Corporations Act, R.S.O. 1960, Chapter 222, and amendments thereto.
3. THE AUTHORIZED CAPITAL of the Amalgamated Company shall be Twenty Million Dollars (\$20,000,000) divided into Five Million (5,000,000) common shares of the par value of Two Dollars (\$2.00) each and Two Hundred Thousand (200,000) 5% cumulative redeemable preference shares of the par value of \$50.00 each, non-voting except when dividends are in arrear for two years, all other conditions to be subject to the approval of the Board of Directors of the Amalgamated Company.
Following amalgamation application will be made for listing the shares of the Amalgamated Company on the Toronto Stock Exchange.
4. THE HEAD OFFICE of the Amalgamated Company shall be at the Town of Lindsay in the Province of Ontario.
5. THE GENERAL BY-LAWS regulating the conduct of the affairs of the Amalgamated Company shall be those of Victoria, subject to repeal, amendment, alteration or addition as provided therein, or in the Loan and Trust Corporations Act, R.S.O. 1960, Chapter 222, and amendments thereto.
6. THE BOARD OF DIRECTORS of the Amalgamated Company until otherwise determined by by-law shall consist of twenty-two members and the first Directors of the Amalgamated Company with their names, callings and places of residence, shall be the following:

E. N. Cooper
S. A. Flavell
C. G. Fleming
G. D. Fleming

Gentleman
Executive
Executive
Executive

Meaford, Ontario
Lindsay, Ontario
Owen Sound, Ontario
Owen Sound, Ontario

J. G. Fraser	Executive	Owen Sound, Ontario
Hon. L. M. Frost, Q.C.	Barrister &c.	Lindsay, Ontario
Hon. Walter Harris, Q.C.	Barrister &c.	Markdale, Ontario
Col. T. A. Kidd	Executive	Kingston, Ontario
W. B. Lemon	Manager	Owen Sound, Ontario
H. J. McLaughlin, Q.C.	Barrister &c.	Toronto, Ontario
G. D. McLauchlan	Gentleman	Owen Sound, Ontario
Wm. L. Moore, Q.C.	Barrister &c.	Orillia, Ontario
Dr. G. A. Morton	Publisher	Belleville, Ontario
F. G. Perrin	Executive	Lindsay, Ontario
J. R. Sinclair	Real Estate Broker	Peterborough, Ontario
R. H. Soward, Q.C.	Barrister &c.	Toronto, Ontario
Brig. J. S. H. Lind, D.S.O., E.D.	Executive	St. Marys, Ontario
Harold R. Lawson, F.S.A.	President	Toronto, Ontario
W. H. Gregory	Executive	Stratford, Ontario
Dr. H. B. Kenner	Physician	Stratford, Ontario
John R. Anderson, Q.C.	Barrister &c.	Stratford, Ontario
S. K. Ireland	Gentleman	Stratford, Ontario

The said first Directors shall hold office until the first annual meeting of the Amalgamated Company or until such earlier time as may be determined by the shareholders thereof and the subsequent Directors shall be elected at either a special general meeting or an annual meeting of the shareholders by a majority vote of the shares represented at such meeting, but such first Directors shall hold office until their successors are appointed. The management and working of the Amalgamated Company shall be under the control of the Board of Directors from time to time subject to the provisions of the Loan and Trust Corporations Act, R.S.O. 1960, Chapter 222, and amendments thereto.

7. THE FOLLOWING shall be the first officers of the Amalgamated Company—

Chairman of the Board	H. J. McLaughlin, Q.C.
President	Hon. Walter Harris, Q.C.
Vice-Presidents	E. N. Cooper
	S. A. Flavell
	J. G. Fraser
	F. G. Perrin
	Harold R. Lawson, F.S.A.

8. IMMEDIATELY FOLLOWING the execution of this agreement the books and records of British shall be open for investigation by the officers and auditors of Victoria, and all the books and records of Victoria shall be open for investigation by the officers and auditors of British for the purpose of enabling the officers and directors of each of the Amalgamating Companies satisfying themselves as to the representations that have been made to them and complete disclosure will be made by the officers and employees of British to the President of Victoria and his representatives of all matters in any way affecting the financial position of British at the present time or in the future. The assets of Victoria and the liabilities to which the same are subject are more particularly set forth in its Balance Sheet as of October 31st, 1964, and the assets of British and the liabilities to which the same are subject are more particularly set forth in its Balance Sheet as of the same date, with such changes as may be necessary to reflect the results of operations and transactions of Victoria and British respectively in the ordinary course of business since that date.
9. EXCEPT as herein provided, the assets, liabilities and surpluses of the Amalgamated Company shall be the aggregate of the assets, liabilities, reserves and surpluses of Victoria and British, all as appearing from their respective books on the date of the assent of the Lieutenant-Governor-in-Council to the amalgamation herein provided for.
10. BRITISH AGREES that pending the adoption of this agreement by the shareholders of both companies and the assent of the Lieutenant-Governor-in-Council thereto it will pay no further dividends to its shareholders. Victoria agrees that it will continue its regular dividend of 12¢ per share quarterly payable on or about the 15th day of September 1965 but will not in the meantime increase payments to shareholders.

11. IT IS AGREED that subject to the assent of the Lieutenant-Governor-in-Council the amalgamation of the two companies shall be effective as of the 30th day of September, 1965, and that the first quarterly dividend subject to amalgamation shall be paid to the shareholders of the Amalgamated Company on the 15th day of December, 1965, and that thereafter, subject to the approval of the Board of Directors from time to time, dividends shall be paid quarterly on the 15th days of March, June, September and December in each year.
12. THE ISSUED and outstanding capital stock of Victoria and British on and from the assent of the Lieutenant-Governor-in-Council confirming this agreement shall respectively be changed and converted into capital stock of the Amalgamated Company in the following manner, namely:
 - (a) each holder of shares in the capital stock of Victoria shall be and be deemed to be the holder of one (1) share of common stock in the capital stock of the Amalgamated Company for each share in the capital stock of Victoria then held by him.
 - (b) each holder of shares in the capital stock of British shall be and be deemed to be the holder of one (1) share of common stock in the capital stock of the Amalgamated Company for each six (6) shares held by him; to the extent that shareholders' holdings of British are not divisible by six (6) each such shareholder shall receive warrants for the fractions to which he is entitled on the basis of $\frac{1}{6}$ th of a share of the Amalgamated Company for each share of British which warrants may be combined with other warrants acquired by him to enable him to acquire full shares of the Amalgamated Company.
- The shareholders of Victoria and British shall when and as required by the Directors of the Amalgamated Company surrender the certificates representing the shares held by them on the date of such assent of the Lieutenant-Governor-in-Council and in lieu of and in substitution therefor and upon such surrender there shall be issued to them forthwith certificates in respect of shares in the capital stock of the Amalgamated Company of which they are then deemed to be the holders.
13. THE PENSION arrangements of Victoria and British will be amalgamated so as to protect fully the interests of all employees of Victoria and British.
14. THE AMALGAMATED Company shall possess all the property, assets, undertakings, business, rights, privileges and franchises and shall be subject to all liabilities, contracts, disabilities and duties of each of the companies so amalgamated.
15. ON AND FROM the assent of the Lieutenant-Governor-in-Council to this amalgamation, all trusts of every kind and description, including incomplete or inchoate trusts, and every duty assumed by or binding upon both of the Corporations, parties to the amalgamation, shall be vested in and bind, and may be enforced against the new or continuing corporation as fully and effectually as if it had been originally named as the fiduciary in the instrument and as provided in the Loan and Trust Corporations Act, R.S.O. 1960, Chapter 222, and amendments thereto. Whenever in any instrument any estate money or other property, or any interest, possibility or right is intended at the time or times of the publishing, making or signing of the instrument to be thereafter vested in or administered or managed by or put in charge of either of the amalgamated companies as the fiduciary, the name of the new or continuing corporation shall be deemed to be substituted for the name of the old corporation, and such instrument shall vest the subject matter therein described in the new or continuing corporation according to the tenor of and at the time indicated or intended by the instrument and the new or continuing corporation shall be deemed to stand in the place and stead of the old corporation, all as more particularly and fully set out in the Loan and Trust Corporations Act, R.S.O. 1960, Chapter 222, and amendments thereto.
16. ALL RIGHTS of creditors to obtain payment of their claims out of the assets of the Company liable therefor, and all liens upon the assets of either or both of such companies shall be unimpaired by such amalgamation and all debts, contracts, liabilities and duties of each of such companies shall thenceforth attach to the amalgamated company and may be enforced against it to the same extent as if incurred or contracted by it.

17. NO ACTION or proceeding by or against Victoria or British shall abate or be affected by such amalgamation but for all purposes of such action or proceeding such company may be deemed still to exist or the Amalgamated Company may be substituted in such action or proceeding in the place thereof.
18. THE AMALGAMATED Company shall pay and discharge all and every of the liabilities of Victoria and British (other than liabilities in respect of capital stock) and all expenses of and incidental to their amalgamation as provided for herein.
19. FORTHWITH upon the shareholders of Victoria and British, respectively, adopting this agreement and the certification of such fact upon a copy hereof by the Secretary of each of such companies under their respective corporate seals, subject to the provisions of this agreement with respect to the dividend of Victoria, an application in the form of a joint Petition by the said Companies shall be made to the Lieutenant-Governor-in-Council for the assent of the Lieutenant-Governor-in-Council confirming this agreement in such form and containing such provisions not inconsistent herewith as may be agreed upon. Pending the assent of the Lieutenant-Governor-in-Council neither Company shall incur any liability or enter into any transaction other than in the ordinary and usual course of business, nor declare any dividends nor make any other distribution of earnings or surplus other than as herein provided for. In the event of such assent of the Lieutenant-Governor-in-Council not being given on or before the thirty-first day of December, 1965, this agreement may be declared by the Directors of either Company to be null and void and of no further force or effect.

IN WITNESS WHEREOF the parties hereto have executed this agreement under their respective Corporate Seals.

VICTORIA AND GREY TRUST COMPANY
by H. J. McLAUGHLIN *Chairman*
W. E. HARRIS *President*

BRITISH MORTGAGE & TRUST COMPANY
by H. R. LAWSON *President*
J. M. ARMSTRONG *Secretary*

It will be noted that, although very much in the minority, six of the nine directors of British Mortgage & Trust were to retain seats on the new Board, but only Lawson was to be one of the amalgamated company's seven officers. By the terms of the agreement, effective only upon approval by shareholders of both companies and the consent of the Lieutenant Governor in Council, the name of British Mortgage & Trust Company, or any vestige of it, was extinguished.

The Run on Deposits and the Ontario Government Guarantee

On the day of this meeting it was announced that the government of Ontario, which had been consulted at every step of the proceedings taken in July, had placed funds at the disposal of British Mortgage & Trust in the amount of \$3,000,000 to maintain its liquid position and make sure that it would be able to meet the demands of its depositors. Details of this transaction, which provoked adverse though uninformed comment at the time, but which alone kept the doors of British Mortgage & Trust Company open and preserved the savings of its depositors, were furnished to the Commission by Mr. H. I. Macdonald, Deputy Treasurer and Deputy Minister of Economics of Ontario. On July 29,

1965 by Order-in-Council OC-2807/65, the Treasurer of Ontario was "authorized to guarantee to the Bank of Montreal, the Canadian Imperial Bank of Commerce and the Royal Bank of Canada due repayment of all deposits made by the said Banks or any of them with the British Mortgage & Trust Company during the period of one year beginning on the 29th day of July, 1965 up to but not exceeding the aggregate principal amount of Three Million Dollars (\$3,000,000) and also to guarantee payment of the interest on such deposits in accordance with the deposit certificates of the said Company". Following the amalgamation of British Mortgage & Trust Company with Victoria and Grey Trust Company on September 30 this guarantee was revoked by Order-in-Council OC-3805/65, dated October 21, 1965, which recited the fact that no deposits had been made with British Mortgage & Trust Company. In consequence none of the funds, in fact, were provided or spent and the giving of the guarantee itself was sufficient for the purpose. An additional factor in maintaining the liquidity of British Mortgage & Trust was the action of the Ontario Hydro-Electric Power Commission which held two deposit certificates, each for \$500,000, with British Mortgage & Trust bearing interest at 5%, one maturing on August 3, 1965 and the other on October 9, the latter however being callable on the August 3 date. On July 30 both certificates were extended from August 3 to December 15, when they were both repaid.

This step, and the news of the proposed merger, were to slow the pace of withdrawal of demand deposits and convert what had been a run into an orderly decline which continued, to some extent, until approval was given to the amalgamation at the end of September. The level of deposits and guaranteed investments, as recorded to the nearest thousand dollars during the six months prior to that time, is illustrated by the following figures:

<i>Month End 1965</i>	<i>Demand Deposits</i>	<i>Term Deposits</i>	<i>G.I.C.'s</i>	<i>Total</i>
	\$	\$	\$	\$
April	33,529,000	8,830,000	73,028,000	115,387,000
May	34,804,000	7,800,000	75,290,000	117,894,000
June	34,887,000	4,695,000	76,478,000	116,060,000
July	23,662,000	2,700,000	76,172,000	102,534,000
August	20,500,000	1,700,000	75,316,000	97,516,000
September ..	19,244,000	1,200,000	74,852,000	95,296,000

Guaranteed investment certificates which were not payable on demand declined only moderately, and this was due apparently to a withdrawal of funds in this category as the certificates fell due. A more graphic

illustration of the effect of withdrawals made by savings and other depositors, whose demands had to be met when made, is shown below:

<u>Date</u>	<u>Balance at date</u>	<u>Withdrawal during period</u>	<u>% of May 31 Balance</u>
	\$	\$	
May 31	34,804,000	—	—
June 30	34,887,000	(83,000)	(.2) %
July 8	34,259,000	628,000	1.8 %
July 15	28,789,000	5,470,000	15.7 %
July 22	25,802,000	2,987,000	8.6 %
July 29	23,661,000	2,141,000	6.2 %
Aug. 5	22,385,000	1,276,000	3.7 %
Aug. 12	21,587,000	798,000	2.3 %
Aug. 19	20,948,000	639,000	1.8 %
Aug. 26	20,499,000	449,000	1.3 %
Sept. 2	19,843,000	656,000	1.9 %
Sept. 9	19,912,000	(69,000)	(.2) %
Sept. 16	19,509,000	403,000	1.1 %
Sept. 23	19,244,000	265,000	.7 %
		<u>\$15,560,000</u>	<u>44.7 %</u>

The combined reduction of demand and term deposits from the end of June until September 23 amounted to approximately \$22,160,000, or 52% of the funds on deposit at the end of May.

* * *

The Extent of the Loss

Having thus carried the narrative forward to the point where the separate existence of British Mortgage & Trust Company, after a life of 88 years, had concluded, I must return to an examination of the company's investments in and loans to what has been described as the Atlantic complex, with a view to determining the loss sustained by it on the realization of these assets and considering the circumstances under which they were made and the motives of those who were responsible for them. Of the total of \$12,200,517 invested or loaned at June 17, 1965 the whole loss was estimated, up until the end of March 1967, at \$6,646,642, taking into account the recovery of sums paid to Victoria and Grey Trust Company by its settlement in the course of 1966 with Commodore Business Machines (Canada) Limited, described in Chapter VIII.¹ This is illustrated by Table 72,² entitled "British Mortgage

¹pp. 491-2.

²Exhibit 4316.

& Trust Company—Estimated Losses on Corporate Investments and Collateral Loans Involved in the Atlantic Complex”, and where there are variations or modifications of these estimates suggested to the Commission by subsequent investigation they will be referred to. The various assets are listed under “Bonds—Corporate”, a generic term including notes and debentures, stocks and short-term notes, and under the heading “Collateral Loans” are listed the securities held as collateral. The table shows the book value of all these holdings at June 17, 1965, the proceeds as realized up to December 31, 1966, the estimated value of the unrealized balance and the estimated total loss in the case of each item.

The first item on Table 72 is Aurora Leasing 7% convertible notes, held as an investment by British Mortgage & Trust at a book value of \$120,300, in respect of which nothing had been realized at December 31, 1966, the trustee in bankruptcy not expecting to recover more than 20% on an unsecured claim; the estimated loss in this case was \$96,300. Commodore Business Machines Series “A” debentures, with a book value of \$50,000, were redeemed by that company at 75% of their face value, so that in this case a loss of \$12,500 was sustained. Notes of N.G.K. Investments were held at a book value of \$38,000 and on these unsecured obligations the trustee estimated a maximum recovery of 10% which would result in a net loss of approximately \$34,000. Among the common stocks the first item is 42,670 common shares of Atlantic Acceptance Corporation, with a book value of \$625,057, on which, by the middle of July, British Mortgage & Trust had realized, by selling all of them, the sum of \$117,512 for an actual loss of \$507,545. Of the 5½% preference shares of Atlantic Acceptance, held at a book value of \$49,135, it sold only 450 for \$5,497 and on the remainder which were valueless, and will probably remain so, the loss in consequence amounted to \$43,638. Atlantic second preference shares Series “A” in the amount of 22,705, with a book value of \$549,811, were also only partly sold before the middle of July to the extent of 12,000 shares which realized \$45,179. Again the remainder proved to be without value and the net loss was \$504,632. The 22,500 common shares of Aurora Leasing Corporation, valued at \$70,285 before the collapse of Atlantic, were estimated to be completely valueless since the company was bankrupt. Commodore Business Machines common shares to the number of 47,250, held at a book value of \$202,469, were included in the settlement with Victoria and Grey Trust Company which sold them all to Irving Gould’s Jaypen Holdings Limited for \$1.50 per share, and the ascertained loss amounted to \$131,593. Commodore Business Machines warrants of which 58,750 were held at a book value of \$17,500 were valued at that amount with respect to the 43,750 which British Mortgage & Trust received as bonuses for the N.G.K.

Investments and Associated Canadian Holdings loans, the remaining 15,000 being carried at no value; none had been sold by the end of 1966 and no reliable value could be established because of the thin market; in Mr. Moreton's opinion the book value of the warrants might be recovered and in consequence no loss has been shown. The 2,000 shares of N.G.K. Investments were written off as early as October 31, 1964, so that there was no book value and the company in any event is bankrupt. Wilfrid Gregory was induced by C. P. Morgan to purchase 500 common shares of Mavety Film Delivery or a 20% interest for British Mortgage & Trust for \$80,000, in a transaction in which he felt the company's earnings had been misrepresented to him by Morgan, and this, according to his evidence, had aroused his earliest suspicions of Morgan's integrity. The purchase was made on April 27, 1965 and the shares were sold in 1966 for \$37,000 for an actual loss of \$43,000. The total investment of British Mortgage & Trust in Atlantic stock amounted to \$1,224,003 on which it realized \$168,188, or only 14% of the whole. It will be recalled that Victoria and Grey Trust Company in April 1966 received 75¢ on the dollar for all of the Commodore Business Machines debentures, except \$50,000 Series "B" which were redeemed at par, and sold the notes and preference shares on which British Mortgage had loaned \$1,500,000 to Trans Commercial Acceptance for \$750,000, plus 50,000 common shares of Commodore Business Machines which were subject to an option given by the trust company to Tramiel and Kapp to buy them back at various prices, beginning at \$1.50 per share. From the Commodore Business Machines debentures, shares and warrants, held for a total of \$269,969, British Mortgage sustained a loss of \$144,093, or approximately 55% of the investment.

Turning to the short-term notes shown on Table 72, it will be seen that of \$2,400,000 invested in the senior secured notes of Atlantic Acceptance a loss of \$600,000 must be expected in view of the estimate of the Montreal Trust Company that 75% of Atlantic's liability in this respect will be recovered. Subordinated notes of the same company were also held at their face value of \$1,000,000 and total loss must be contemplated. Then there was the Treasure Island Gardens note for \$750,000 which was endorsed by Atlantic and treated as an Atlantic note by British Mortgage & Trust in reporting to the Registrar. The loss on this investment is also considered to be complete. The strikingly large amount invested in the notes of Aurora Leasing Corporation which turned out to be unsecured, a discovery which for the first time revealed to Lawson and other knowledgeable observers the possible extent of British Mortgage's loss, has been dealt with on the same basis as the longer-term convertible notes and the estimated value of the company's claim fixed at 20% of the book value of the investment, resulting in an expected loss of \$1,488,000. More must be said later about W. P.

Gregory's connection with this company, the circumstances under which the loans were made and the reasons for misrepresenting their status as investments to the Registrar of Loan and Trust Corporations. Finally, in the category of short-term notes is that of London Lighthouse Investments, already discussed in Chapter VII³ with reference to Gregory's knowledge of the transaction. Victoria and Grey Trust subsequently relinquished its claim for a payment of \$55,000 and a loss of \$425,000.

The first item under the heading "Collateral Loans", the loan to members of Annett & Co., had been paid off in full by the end of 1966. Three notes of C. P. Morgan, two for \$200,000 and a third for \$250,000, were collaterally secured by Commodore Business Machines Series "B" debentures, Atlantic Acceptance common shares and other common stock which were sold to realize \$237,193, leaving only shares of Five Wheels Limited on which additional recovery of \$17,200 was a possibility. The total loss on these advances to Morgan of \$650,000 would, on this assumption, amount to \$395,607. As part of the settlement between Victoria and Grey Trust Company and Commodore Business Machines, loans to Manfred Kapp and Jack Tramiel were fully paid with some assistance from the treasury of Commodore Business Machines. Full recovery was also expected from the loans to various persons connected with Great Northern Capital Corporation, secured by shares and debentures of Western Heritage properties. The loan to Harry Wagman of \$100,000, also secured by Commodore Business Machines Series "B" debentures, had by the end of 1966 been recovered to the extent of \$86,458 and the estimated loss is \$13,542. The loan to Associated Canadian Holdings, carried in June 1965 at a book value of \$192,500, also benefited from the settlement between Victoria and Grey and Commodore Business Machines, the proceeds realized by the end of 1966 being \$187,500, leaving an estimated loss in consequence of \$5,000. The same may be said of the loan of \$240,000 to N.G.K. Investments of which all but \$26,000 had been recovered by the end of 1966. The same settlement, and the valuation of Commodore Business Machine notes and preference shares at 35% of face value, produced a recovery of \$750,000 from the large loan to Trans Commercial Acceptance, carried by June 1965 at a book value of \$1,450,000; the face value of the securities was \$2,000,000 and, bearing in mind that 50,000 common shares of Commodore Business Machines were received by Victoria and Grey, subject to the option given to Tramiel and Kapp, the estimated loss in this case is \$625,000. On the loan to Western Heritage Properties of \$500,000, secured as has been seen by a guaranteed note of that company's subsidiary Sherwood Properties for \$1,000,000, full recovery is expected.

³pp. 283-7.

A summary of the figures shows that at the end of 1966, out of a book value of \$12,200,517 for these investments and loans, the sum of \$2,847,195 had been recovered and that an additional \$2,581,680 will probably be collected.⁴ An additional element in the total loss experienced by British Mortgage & Trust, and one of uncertain size, was the state of the mortgage portfolio and the real estate held for sale. Against this the company held a reserve of \$900,900, which, as the Commission was advised, Victoria and Grey Trust Company as late as the spring of 1967 felt was sufficient: some further examination of the larger mortgage loans must be made. Suffice it to say at this point that, to the extent mortgages were in default and the successor company must wait or work for ultimate repayment, or, in default of this, the application of its reserve, there is an ensuing loss of liquidity and opportunity for reinvestment of funds. The effect of a loss of upwards of \$6,500,000 must be measured against the total equity shown on the balance sheet for June 30, 1965⁵ of \$6,252,689 which is simply wiped out by the loss on investments in the Atlantic complex alone. Although no depositor or holder of guaranteed investment certificates of British Mortgage & Trust Company lost money, the company's shareholders suffered a greater than 90% loss of their investment based on the market value of the shares prevailing before the Atlantic default. The value per share of \$2.50 attributed to those of British Mortgage & Trust, after a total loss of capital and reserve, evidently arose solely from the loss available to be carried forward for income tax purposes and the company's position as a going concern. Thus, by a narrow margin, the prospect of an Ontario trust company, nearly a century old, closing its doors in a season of great prosperity was averted.

⁴As a footnote to the estimate and determination of losses contained on Table 72 reference should be made to careless conveyancing by Carl M. Solomon when a general assignment of book debts was given by Aurora Leasing Corporation to Commodore Sales Acceptance as early as December 21, 1960. Solomon, as president, and Harry Wagman, as secretary-treasurer, executed the assignment for Aurora Leasing and Solomon then made the affidavit of *bona fides*, also in his capacity as president of the assignor. If, as one might expect, the assignment is held to be invalid because of failure of the assignee to make the affidavit, Victoria and Grey Trust Company might expect to recover something extra on the British Mortgage loans to Aurora, the probable recovery being in the order of 25%; if on the other hand it is held to be valid no recovery can be foreseen. Again, the most recent estimate of the Clarkson Company is that the dividend on the bankruptcy of N.G.K. Investments will be closer to 20% than the 10% indicated on Table 72 and that the residual claim of British Mortgage & Trust against the estate of Associated Canadian Holdings could produce about \$1,000 more than the amount shown. Estimates from the same source indicate that recovery from the bankruptcy of Trans Commercial Acceptance may exceed \$100,000 rather than \$75,000 as at present indicated. Therefore a conservative estimate, based on recent information, would reduce the total loss to approximately \$6,740,000 if Aurora's assignment is invalid, and increase it to \$7,100,000 if it is effective. Although its status is unresolved there never was any doubt about its existence which was reported in the financial statements of Aurora Leasing, a fact upon which Wilfrid Gregory was invited to comment (p. 1111), and it was registered in the County Court of the County of York (Exhibit 4971).

⁵Exhibit 4230.

Personal Losses of W. P. Gregory

Over the whole period of its existence British Mortgage & Trust Company had only four managing directors and two of these over a period of forty years had been the Gregorys, father and son. The evidence indicates that one of the elements of the confidence reposed in them by their fellow directors was the large investment which they, and members of their family, were known to have in the company. Their personal loss was shattering. An estimate of the assets and liabilities of Wilfrid P. Gregory as at June 17, 1965, taken from the bank records, share registers and brokerage accounts, appears below.¹ Market prices are as at the close of business on June 11, 1965, which was the last day markets were open prior to the Atlantic default, and therefore on which it can be said that prices were unaffected by a general knowledge of Atlantic difficulties.

ASSETS**Cash at Banks**

British Mortgage & Trust Company		
a/c 10,330	\$ 692	
British Mortgage & Trust Company		
a/c 14,457	629	
Royal Bank of Canada, Stratford	1,198	
Canadian Imperial Bank of Commerce, Stratford	755	\$ 3,274

Securities

Shares in listed companies and British Mortgage & Trust—at market values on June 11, 1965	\$1,226,975	
Securities of unlisted companies—at cost ..	77,897	1,304,872
		<u>\$1,308,146</u>

LIABILITIES**Bank Loans**

Royal Bank of Canada, Stratford	\$ 36,000	
Canadian Imperial Bank of Commerce, Stratford	24,000	
Canadian Imperial Bank of Commerce, Toronto	476,401	
Bank of Montreal, Stratford	14,000	
TOTAL LIABILITIES		<u>\$ 550,401</u>

ESTIMATED PERSONAL NET WORTH

at June 17, 1965	<u>\$ 757,745</u>
------------------------	-------------------

¹Exhibit 4338.

No real estate is shown as an asset because Mrs. W. P. Gregory owned the house in which she and her husband lived in Stratford, and the only other real estate of which the Commission has knowledge was a half interest in a summer cottage owned by Wilfrid Gregory and his brother John. His holdings in securities of listed companies and of British Mortgage & Trust, with their market value at June 11, 1965, and of private companies, valued at cost because of the difficulty of determining a market price, compiled from the same records, are as follows:²

SECURITIES OF LISTED COMPANIES
AND BRITISH MORTGAGE & TRUST
COMPANY AT JUNE 17, 1965

<u>No. of Common Shares</u>	<u>Company</u>	<u>Price per Share</u>	<u>Market Value</u>
1,700	Atlantic Acceptance Corporation Limited	\$20.25	\$ 34,425
37,630	British Mortgage & Trust Company	30.00	1,128,900
496	Analogue Controls Inc., 5300 warrants	—	—
4,000	Commodore Business Machines (Canada) Limited	7½	30,500
	Commodore Business Machines (Canada) Limited, 7800 warrants ..	4¼	33,150
			<u>\$1,226,975</u>

SECURITIES OF PRIVATE COMPANIES
AS AT JUNE 17, 1965
(Valued at Cost)

<u>No. of Common Shares</u>	<u>Company</u>	<u>Cost</u>
5,000	First Caribbean Island Properties Limited	\$ 5,125
5,000	Frederick's Department Store Limited	10,005
20,267	Aurora Leasing Corporation Limited	20,267
3,000	Granite Investment & Development Limited	15,000
1,959	Kist Canada Limited	2,000
1,300	General Lawn Spray Limited	1,300
201	N.G.K. Investments Limited	200
	N.G.K. Investments Limited, convertible notes ..	12,000
99	Stratford Industrial Properties Limited	12,000
		<u>\$77,897</u>

Gregory's position after the collapse of Atlantic Acceptance, and the development of the difficulties under which British Mortgage & Trust Company found itself as a result, is illustrated by a statement of affairs

²Exhibit 4338.

entitled "Unaudited Statement Prepared by Mr. Gregory", supplied to the Canadian Imperial Bank of Commerce and certified to the Commission to be a true copy by the assistant secretary of that institution.³ The date of the statement is July 20, 1965 and it is divided into "Liquid Assets" and "Fixed Assets" on the one side, and "Floating Liabilities" and "Deficit" on the other. The customer's business is described as "ex-President, British Mortgage & Trust Company" and, although the effective date is stated to be July 20, it was apparently prepared on July 29 for the information of the head office of the bank in Toronto. The list of marketable securities under liquid assets is substantially the same as that shown at June 17, with the exception of 1,700 shares of Atlantic Acceptance and the shares and warrants of Commodore Business Machines. The liquid assets listed are cash of \$1,000 and marketable securities valued at \$112,075, and the fixed assets consist of the half-interest in the cottage valued at \$5,000 and a 1963 Rambler convertible automobile at \$1,500, bringing the total assets to \$119,575. Liabilities were made up of the aggregate of the loans from the Canadian Imperial Bank of Commerce in the amount of \$500,401 and a loan from the Royal Bank of Canada in the amount of \$32,000, for a total of \$532,401. The net position was a deficit of \$412,826.

The 1,700 shares of Atlantic Acceptance were sold off by the Royal Bank at Stratford, realizing \$10,003.28, and these proceeds were applied against his loan. The Commodore Business Machines securities had been pledged with the Bank of Montreal in Stratford in July 1964 against a loan of \$19,500 and on July 2, 1965 these were released to Gregory after reduction in the loan of \$5,400, the market price of the shares being at that time \$2.85. This loan was wholly paid off by July 7 and further security of 165 shares of British Mortgage & Trust was also released. The bulk of Wilfrid Gregory's loss of approximately \$1,000,000 represented the decline in value of his 37,630 shares of British Mortgage & Trust Company from \$30 to \$2.50 per share which reduced him from a position of great affluence to one of apparent insolvency and debt. Illustrating the swing of the pendulum, by the time he came to make his statement of affairs for the Canadian Imperial Bank of Commerce the valuation of his shares in private companies at cost tended to inflate the ultimate value of his assets, especially in the case of the shares of Aurora Leasing, N.G.K. Investments, Frederick's Department Store and General Lawn Spray, the securities of which by then were recognized to be worthless.

Gregory's trading in the shares of Atlantic Acceptance provided him with 100 common shares at the end of 1960, and 1,700 by the end of 1961.⁴ This increase arose, in the main, from his participation in the

³Exhibit 4339.

⁴Exhibit 4325.

sale to Atlantic of the minority interest in Commodore Sales Acceptance⁵ described in Chapter V.⁶ There was no further trading in Atlantic shares until, on November 27, 1964, he bought 1,000 for \$20,550. These were sold between May 21 and June 3, 1965 for \$20,-583.25, so that he only retained his original 1,700 shares which had cost him \$7.44 per share. His trading in Commodore Business Machines common stock was revealed by an examination of brokerage accounts of Annett Partners, Barrett, Goodfellow & Co. and J. H. Crang & Co. On July 10, 1962 he bought 1,000 shares from Barrett, Goodfellow & Co. at \$2.50 per share and had sold them, together with 840 shares purchased in August, by September of that year. Another 5,000 were bought through Annett Partners on November 7, 1963 of which 1,000 were sold between March 24 and June 1, 1964, leaving him with 4,000 shares which were pledged with the Bank of Montreal and ultimately sold, as already indicated, between June 24 and July 8, 1965, under circumstances which caused him a loss of about \$1,000 over the whole period of trading. Purchases of Commodore Business Machines warrants through Annett Partners and J. H. Crang & Co. began on October 24, 1963 and by the end of 1964 he had accumulated just over 11,000. Before the collapse of Atlantic 3,450 had been sold and 4,700 had to be disposed of in late June and July of 1965 at prices of about \$1.25. The remainder were apparently not sold and the Commission has no knowledge of their disposal. This trading was moderately profitable.⁷

It has already been observed that by far the greater part of Wilfrid Gregory's considerable fortune, as it existed before it was drained away in the vortex of the Atlantic failure, was invested in shares of British Mortgage & Trust Company and evidence was given about his holdings and those of his father and other members of the Gregory family.⁸ The old shares, with a par value of \$100 before the 20-for-1 split in February 1963, had an approximate market value varying from \$250 per share in 1960 to somewhat over \$40 for the new shares in the winter of 1963 and 1964, declining to approximately \$30 a share in May of 1965. W. H. Gregory in April 1960 had 542 of the old shares and by the end of 1962 he had 806. At the end of May 1965 his shareholdings amounted to 15,329 of the new shares with a market value of some \$460,000; at the merger with Victoria and Grey Trust they were worth \$38,000. Wilfrid Gregory in April 1960 had 100 of the old shares and, after some purchases and sales, stabilized his holdings at 2,000 in April of 1962. These became 40,000 new shares in February 1963 of which he sold 5,000 in October of that year to Gormley Investments. He bought a further 1,275 shares in December 1964 and 165 in March

⁵Exhibit 3266.

⁶pp. 126-8.

⁷Exhibit 4340.

⁸Exhibit 4341.

1965, holding immediately before the Atlantic default 36,440 shares with a market value of \$1,093,200. These however had been acquired by heavy borrowings, first from Commodore Sales Acceptance and Aurora Leasing Corporation, and then from the Canadian Imperial Bank of Commerce to which they were pledged, in August 1965 being transferred into the name of Gee and Company, a nominee of the bank, and valued at \$2.50 per share. It is not clear whether the bank took these shares in partial satisfaction of his debt and, since his loan account does not show a credit of that value, it is possible that the bank contemplated transfer in the future. At the end of May 1965 the Gregory family as a whole held 56,773 shares, somewhat more than a sixth of the total issued, with a market value of \$1,703,190 at the prevailing price, and these suffered a decline in value to \$141,933; after deducting Wilfrid Gregory's shares, 19,683 were left and the value at \$2.50 per share was \$49,208.

Losses in Estates, Trusts and Agencies

The annual statement to the Registrar for the year ended October 31, 1964 recorded \$4,995,159 under administration by British Mortgage & Trust Company as executor, trustee or agent.¹ The managing director's report to the board for the same period stated that there were 19 agencies, six pension trusts and 176 retirement savings plans, with an unspecified number of estates, having investments, for a total book value of \$2,626,457.71. From a schedule prepared by Victoria and Grey Trust Company, showing the position and losses in the various estates, trusts and agencies accounts as at October 1, 1965,² Mr. Moreton prepared a revised statement, after a minor correction, which appears as Table 73³ entitled "Summary of Losses to Estates, Trusts and Agencies Arising from Investments by British Mortgage & Trust in Atlantic Acceptance Corporation and its Affiliates". In the various agencies where British Mortgage & Trust exercised its right to invest funds it appears, from a bundle of memoranda from R. R. Swanson, assistant manager of the trust department, to W. P. Gregory found in the trust company's files,⁴ that, whenever funds were available to be invested, Swanson informed Gregory and the latter would indicate in handwriting on each memorandum what should be purchased. Eleven out of the 19 agencies held shares of Atlantic Acceptance Corporation and 13 held those of Atlantic, British Mortgage & Trust or Commodore

¹Exhibit 2561.7.

²Exhibit 4328.

³Exhibit 4329.

⁴Exhibit 4330.

Business Machines. All of the six pension trusts held Atlantic shares, but of the 176 retirement savings plans only 12 held British Mortgage & Trust shares and two those of Atlantic Acceptance. Six estates held Atlantic shares and three those of British Mortgage & Trust. In all 52 estates, trusts and agencies were shown as holding either Atlantic Acceptance or British Mortgage & Trust securities. The book value of their investments was \$3,020,186.02 and of this amount \$301,158.59 was invested in Atlantic shares, based on the book value attributed by British Mortgage & Trust at the time of commencement of the administration of the assets; this would reflect either market value at the date when the company took over administration or cost when the investment was made, the company schedule making such a distinction by using the letters "I.A." for an invested asset and "O.A." for an original asset. After the collapse only \$4,574.47 was recovered and the loss amounted to about 98%. Estates, trusts and agencies funds were also invested in shares and warrants of Aurora Leasing Corporation, Analogue Controls and Commodore Business Machines, with a book value of \$40,524.37 of which only \$8,048 was recovered. For 12,611 shares of British Mortgage & Trust, with a book value of \$210,576.26, held in this category the ultimate valuation of \$2.50 per share reduced them to \$27,702.25, excluding however 1,800 shares which were returned to the principal of one agency and the disposition of which is unknown, so that the ascertained loss must be reduced to \$140,089.01. Adding together the investment in the shares and securities of Atlantic Acceptance, Aurora Leasing Corporation, Analogue Controls, Commodore Business Machines and British Mortgage & Trust Company held by the 52 estates, trusts and agencies, with a book value of \$552,259.22 and a market value on June 11, 1965 of \$669,220.62, there was a combined recovery on realization of \$40,324.72. Taking all the estates, trusts and agencies assets under administration into account, the loss amounted to some 16% of the whole.

The twelve retirement savings plans which held shares of either British Mortgage & Trust or Atlantic Acceptance suffered a loss of \$31,379.86 against a book value of these shares in the amount of \$34,570.86. An additional trust fund administered by the company was described as an equity fund, in spite of Wilfrid Gregory's disclaimer to the Registrar that it conducted such an activity. At July 15 the book value of investments by this fund was said to be \$106,345 and included 700 common shares of Atlantic Acceptance, 300 second preference shares of Atlantic Acceptance, 800 common shares of Analogue Controls, 1,000 common shares of Aurora Leasing Corporation and 1,700 common shares of Commodore Business Machines, from which the fund experienced a loss of \$30,457.75.

The Liquidation of Holdings of Atlantic Acceptance Stock

In the liquidation of its holdings of the shares of Atlantic Acceptance Corporation, as either investment or collateral security, British Mortgage & Trust Company adopted a strange procedure about which some comment must be made. Its holdings as a company, other than in its capacity as trustee, have already been referred to. These it began to sell on July 5, 1965 and by July 13 had sold all the 42,670 shares in the company account, together with 18,000 shares held as collateral, at prices ranging from \$4.49 down to \$1.25 before it sold a single share of those held in trust. Then on that date it sold all the common shares of Atlantic Acceptance held for estates, trusts, and agencies to the number of 3,960, for which the proceeds were \$4,244, with the exception of 190 shares which were delivered to the principal of one particular agency. The average price received for its own stock was \$2.75 and for the shares held as collateral \$1.34, compared to \$1.07 per share for the stock held as trustee. The same procedure accompanied the sale of second preference shares, in that British Mortgage & Trust began selling out its own position on July 5 and continued to do so until July 15. Prices began at \$6 to \$6.50 and the shares which had a par value of \$24 sold down to \$2 on the latter date, for a total of 12,150 sold out of 22,705 and a net recovery of \$45,379. Then on July 15 it sold 150 out of the 7,770 shares which were held in trust and recovered \$330; the rest of the shares were not sold since presumably there was no market.¹

The first reference to the collapse of Atlantic Acceptance in the records of the company occurs in the minutes of the executive committee for its meeting on June 22.² This contains the president's comment on the "recently publicized default of Atlantic Acceptance Corporation", saying that the matter would be followed closely and further reports would be submitted. On this occasion he also reported that he had resigned from the board of Atlantic Acceptance and that C. P. Morgan had resigned from the trust company's Toronto advisory board. The next day the Royal Bank of Canada in Stratford sold out his own holdings of Atlantic shares. There is no reference in the minutes of either the executive committee or the board of directors to any discussion of the desirability of selling the company's holdings of these securities thereafter until the board meeting on July 13,³ when there is a minute, under the heading "Estate and Trust Investments", of a motion of Messrs. S. K. Ireland and A. B. Manson which authorized the sale of Atlantic Acceptance shares and recorded the consent of the co-executors and principals of agencies. This minute refers to the "committee" authorizing the sale but, since it is contained in the minutes of the meeting of the board and

¹Exhibit 4343.

²Exhibit 112.

³Exhibit 111.

Ireland was not a member of the executive committee, this must be an error. If the Atlantic common shares held in trust had been sold on July 5 and 6, as a much larger number of the company's own shares were, they would have commanded an average price of \$3.38 for 4,150 shares instead of \$1.07 for 3,960 shares on July 14. Similarly, if the preference shares held in trust had been sold first, all 7,770 of them would have been sold by July 7 at prices ranging from \$6.50 to \$4 per share for an average price of \$4.54; the proceeds would have been \$35,285 instead of \$330 for the mere fragment which could be sold by July 15. Looking at the situation in another way, even if all the common and preference shares of Atlantic Acceptance had been treated together, as one item in a portfolio which did not distinguish between trust and company funds, and the proceeds actually realized divided ratably between the company on its own account and as trustee, 64,630 common shares sold at an average price of \$2.26 per share which realized \$145,931 would, by such apportionment, have raised the amount of recovery for estates, trusts and agencies to \$8,941 and the loss would have been less by \$4,697. Proceeds of all the preference shares sold to the number of 12,150 at an average price per share of \$3.76 amounted to \$45,709. The company held 22,705 shares and estates, trusts and agencies 7,770 shares for a total of 30,475. If the shares sold had been apportioned between the two accounts so that the loss was equally sustained, the result would have produced a realization for the company of \$34,055 and for estates, trusts and agencies of \$11,654, or \$11,324 more than the actual proceeds of \$330. The total increase on recovery, therefore, under this treatment of the process of realization for estates, trusts and agencies would have amounted to \$16,025. But if, on the other hand, British Mortgage & Trust Company, acting faithfully as a trustee in accordance with well-recognized principles of jurisprudence, had sold the Atlantic shares of both kinds held for estates, trusts and agencies between July 3 and July 5 at the prevailing prices before it unloaded its own holdings, all the common shares held in that account would have realized \$14,045 and the preference shares \$35,278; the total saving to estates, trusts and agencies would have amounted to \$44,749. An additional and imponderable factor might also have sensibly increased this figure, since the shares held by estates, trusts and agencies, being less in number than those of the company, might have commanded higher prices if sold first by exerting less downward pressure on the market.

Wilfrid Gregory was naturally questioned about this before the Commission and as to why British Mortgage & Trust did not, in any event, sell its Atlantic securities earlier.⁴

"Q. There is evidence before the Commission to the effect that the company held substantial Atlantic securities for its Estates, Trusts and

⁴Evidence Volume 116, pp. 15926-9.

Agencies, a sum in the order of three hundred thousand odd dollars. Does that sound correct?

A. I don't know; it could have been. It was spread over a good number.

Q. The company sold its Atlantic shares and securities on the—beginning on the 2nd of July, 1965, and selling on up to the 15th of July. At that point in time it began to sell for the Trusts. Now, first, can you tell me why the company did not sell its Atlantic securities earlier than the 2nd of July? Were you still hopeful, or what was your judgment of it?

A. I think basically, thinking back, that things were out of my hands. I wasn't making the decisions any more after this thing lost, after the collapse. The directors had lost confidence in me and I had lost confidence in myself. Now, I think we didn't do anything, we were hoping for the best, and the information we got indicated there might be hope. Starting in July I was told, I think, to start selling Atlantic, and I didn't think of bringing up the question of Estates or Trust shares, and there is always a nice question, what do you sell first. It is a fundamental question with trust companies, between their own trust securities, because you do not know what the market is going to do from one day to the next. You don't know—I can't tell you tomorrow what is going to happen to any particular stock; but, tomorrow I can tell you what happened today. We may have been criticized but I didn't do any of this myself. Whoever did. Or, the company may have been criticized as much if Atlantic had dropped down and everything had been sold and, then, it suddenly recovered and you would have looked like a fool.

Q. The company, having sold, beginning on the 2nd of July, did you direct your mind at all to the question of whether or not the company was under any obligation to divided the proceeds of such sales as were made ratably with the trusts?

A. Well, I didn't. As I say, I was no longer in control of the company, even though I didn't resign until the 27th. I was making no decisions, other than the ones involved in trying to keep the company afloat and keeping liquidity going and keeping up on our feet.

Q. You say the directors lost confidence in you and you had lost confidence in yourself?

A. Right.

Q. Would that loss of confidence stem from about the beginning of July?

A. No, right after Atlantic there were some things I had to do, but, certainly, starting the beginning of July, when more active steps had to be taken I wasn't taking them.

Q. Do I understand then, that so far as you, yourself, are concerned, the question of whether the proceeds of both sales should be divided at least ratably with the trusts in all the circumstances, you simply did not advert to it?

A. I didn't, that is right, sir.

Q. Is there anything else you want to say on that particular part?

A. That particular part, there is nothing else I can, no, sir."

Both Lawson and Anderson agreed with Gregory that the question of priority in this matter had been overlooked. Of all the directors, other than Wilfrid Gregory, one might have expected J. M. Armstrong, the assistant general manager and secretary, whose peculiar function was the administration of estates, trusts and agencies, to be principally concerned with their plight. Yet it has been seen that his assistant Swanson referred questions of investment to the president himself, and Armstrong in evidence took a somewhat rigid view of his responsibilities.⁵

"Q. Mr. Armstrong, respecting the sale of the company's holdings of Atlantic in early July and the subsequent decision on or about the 15th of July to sell the trust holdings of Atlantic, who made the decision to sell the trust holdings of Atlantic?

A. Well, the decision to sell the trust holdings insofar as the sole trusteeship or sole executorship would be concerned would be the responsibility of the executive committee or the board on my recommendation. Insofar as co-executorships or co-trusteeships or agencies are concerned, it could only be done after we had the approval of the trustee or the principal.

Q. As it appears by the minutes, your recommendation was considered on the 13th of July. Does that substantially agree with your recollection?

A. I wouldn't disagree with it, sir.

Q. Were you aware that the company had been selling out its position from the 2nd of July? That does not appear to have been discussed at a board meeting.

A. No, I cannot say that I was aware of it, no, sir.

Q. What reasons operated to cause the delay in selling out the trust position? Was there some hopes of greater recovery being made with patience, or what was it?

A. No. We reviewed all the trust accounts and had a report made of those accounts which held Atlantic stock showing the cost price, and at the earliest opportunity the co-executors and the principals and so forth were contacted to obtain their views. Now, when I say the earliest opportunity, I must also say that we did not feel, I did not feel that there was any immediate concern to dump the Atlantic stock because the Atlantic shares we held in the accounts all qualified as authorized investments for the respective accounts. Certainly I didn't have any knowledge that the preferred shares were going to diminish too much in value but perhaps I didn't have just as much time to consider those things as I might have.

Q. Did you discuss this aspect of the matter with Mr. W. P. Gregory at any time, that is, as to whether it would be advisable to sell Atlantic?

A. I am afraid the days and nights weren't long enough right then.

Q. I take it from what the other directors have said that later on the question of whether the proceeds of the sale of Atlantic should be divided ratably between the company and the trusts simply never came up for discussion. Is that true?

A. Not in my presence, no.

Q. Mr. Armstrong, who made the decision as to which particular shares should be purchased with trust funds, whether it was Bell Telephone or what-have-you?

A. Mr. Gregory would make the recommendations.

Q. Mr. Swanson apparently would inform Mr. Gregory at the time that moneys were available?

A. We set up a review system and Mr. Swanson was responsible for the details of that review to see the accounts were reviewed. He would review the investment portfolio with Mr. W. P. Gregory, and Mr. Gregory would submit his recommendations as to the sale and purchase of stocks and bonds and so forth. Those would be submitted then to the next executive committee for approval, provided they were authorized investments for the particular accounts."

Here it may be noted that Armstrong did not suggest that the prospect of looking foolish in the case of a dramatic recovery of Atlantic securities on the stock occurred to him, as it did to Wilfrid Gregory. Due weight must be given to the delay involved in securing the consent of co-executors and principals to the liquidation of their Atlantic securities, but it does not seem that any sense of urgency prevailed in this matter sufficient, in any event, to abridge a period of two weeks which elapsed between commencement of the sale of the company's shares and those in the estates, trusts and agencies account. Nor was any attempt made during the remaining life of the trust company to rectify this strange and unjustifiable preference of its own holdings over those of the beneficiaries who relied upon it as a trustee.

The Aurora Leasing Investment

Other companies of the Atlantic complex in which both British Mortgage & Trust and its managing director personally were involved were, of course, Aurora Leasing Corporation and N.G.K. Investments. The acquisition of the company's interest in Aurora Leasing has been referred to in Chapter V¹ but some recapitulation should be made. On November 10, 1960, according to the company's records, it paid

¹pp. 157-9.

\$80,000 to Solomon & Singer and acquired 1,000 common shares of Aurora and \$60,000 worth of unsecured 7% convertible notes. The 1,000 shares represented 20% of Aurora or the limit permitted by the Loan and Trust Corporations Act for ownership of shares in another company. An additional \$10,000 was paid to Solomon for the purchase of 250 shares in the name of Ann P. Gregory and a further 250 shares in the name of Annett & Co., all of which were subsequently registered in the name of Wilfrid P. Gregory. On February 8, 1963 British Mortgage & Trust purchased another 1,000 shares from the treasury of Aurora and, since the common shares were split 10-for-1 in May of that year, the effect was to give the trust company 20,000 of the new shares. In addition, it had, on May 12, 1961, subscribed for an additional \$60,000 in promissory notes for which it paid \$57,000, a discount of 5% in a purchase permissible under the "basket clause" of the Act. On October 27 of the same year British Mortgage & Trust's holdings under the "basket clause" were relieved of this burden by an unusual transaction in which the company appeared to sell all of its Aurora notes to Annett & Co. for \$117,000, and on November 13 to buy them back again for \$120,300, although no change of ownership was recorded in consequence in the convertible notes certificate book of Aurora Leasing. An additional 1,400 shares were bought on September 13, 1963 through Annett & Co. at a price of \$4 per share and on October 2 a further 1,450 shares at the same price; thus the company held in October a total of 22,850 or an amount in excess of 20% of the total issued shares. The auditors observed this and Campbell, Lawless & Punchard wrote a letter to British Mortgage & Trust,² pointing out that this situation constituted a breach of section 142(1)(b); as a result, 350 of its shares were sold to Wilfrid Gregory at \$4 on November 25 and the auditors were advised that the required adjustment had been made.³ Thereafter British Mortgage & Trust owned notes with a principal value of \$120,000 for which it had paid \$120,300 and 22,500 common shares for a net cost of \$70,285.

Having acquired a 5% interest in the common shares of Aurora Leasing from his wife and Annett & Co., Gregory by April 14, 1965 held 21,267 shares⁴ or roughly 17% of the outstanding stock; at this time British Mortgage & Trust was the largest single shareholder of Aurora and Gregory the second largest, and between them they held approximately 35% of its equity. The minutes of the meeting of the trust company's executive committee held on November 15, 1960⁵ record approval of its original purchase on November 10, and subsequently it approved

²Exhibit 4268.2.

³Exhibit 4268.3.

⁴Exhibit 978.

⁵Exhibit 110.

the purchase of February 8, 1963.⁶ The board of directors on September 10, 1963 authorized the purchase of 1,400 shares made on September 13,⁷ and on October 8 that of the 1,450 made on October 2. Although, as has been seen, this had the effect of exceeding the limitation of 20% imposed by the statute, there is no mention of the correspondence with the auditors, or the sale of 350 of these shares to Wilfrid Gregory, and no reference in any of the minutes to him disclosing his own share interest when these purchases were either authorized or approved. The various acquisitions of Aurora shares and notes were put to Gregory by counsel and the examination continued as follows:⁸

“Q. Now, who suggested it to you that British Mortgage and you should buy notes and shares of Aurora?”

A. Well, I remember a meeting in Mr. Morgan’s office, with Mr. King, where Mr. Morgan placed these—the details of this transaction before us, and I don’t remember who first suggested it, but it arose there and Mr. Morgan stated that he had this Canadian company over an American company, that was for sale, and he thought it could be profitable, it was in the leasing business, and he wanted Mr. King to arrange some financing and he asked me what we would take.

Q. Just one moment, Mr. Gregory, what do you mean by ‘a Canadian company over an American company’?”

A. A Canadian subsidiary, I am sorry, a Canadian subsidiary of an American company, and said—and he was buying, he told me—I don’t know whether it is true or not—he said he was buying this Aurora from a group of people in Cleveland or somewhere, who had the American company here operating it here, and they wanted to sell it.

Q. I see. Did you understand you were buying it from an American company or from some Americans?

A. We were buying these shares from some Americans who—but they were supposed to also have a company in the United States, and I guess they had this Canadian company as well.

Q. And did you understand that you were buying from them in the first instance, that is there was no middle man, from your understanding?

A. I understood that they were buying it direct from them.

Q. And what did you consider that the company thereafter would do?

A. Well, I was told, and I considered—and this was quite a bit of the basis for buying it, that it was going into the leasing business, that it was in the leasing business, and was going to continue in the leasing business, and from time to time I was told of certain types of things it was buying, and this was one of the areas of financing which seemed to offer good profit possibilities at the time, and I was interested in it, and I was

⁶Exhibit 112.

⁷Exhibit 112.

⁸Evidence Volume 115, pp. 15618-24.

quite pleased to have this possibility, because leasing is a form of financing that we could not do ourselves and I felt that by buying an interest for a reasonable amount in a small company, it would broaden our diversification.

Q. What did you understand the company would be leasing?

A. Well, they were starting off—I understood they owned trucks for one thing, that they were leasing, that they would be leasing office equipment, that they would be leasing machinery and equipment to chain stores, which—a lot of which is done on a leasing basis, butchering equipment—these occurred to me at the time, but it is the sort of thing—they said office equipment and desks.

Q. When did you learn that in fact Mr. Morgan, Mr. Walton and Mr. Wagman bought this company from one Meckler, one Lazar and one Rashkis, caused the company to sell the vehicles and equipment which it had been leasing, and in the course of a complicated transaction purchased the shares of the company with the money of the company?

A. When I read it in the Globe and Mail after it appeared at this inquiry.

Q. Who were to be the directors of the company according to your understanding?

A. When we bought Aurora?

Q. Yes.

A. I don't remember, I don't remember it was ever discussed with me. There may have been names suggested, but I don't recall them if there were.

Q. They were in fact originally Messrs. Solomon, Singer and Walton, with Mr. Wagman as secretary treasurer, and that was ultimately changed, and Mr. Laidlaw, I believe, became president, did he not?

A. Yes.

Q. Who was going to manage the company?

A. There were at first—there would be a management contract with Management—Chartered Management.

Q. Yes.

A. And then later Mr. Laidlaw was brought in as president.

Q. Whom did you understand Chartered Management to be?

A. I don't know who it was other than I believe the firm of Walton, Wagman and Mr. Morgan was mentioned.

Q. Who did in fact make the decisions respecting loans in Aurora so far as you were aware?

A. Well, I expect that Mr. Morgan made all of the decisions, and I am not sure what I learned now, and what I knew, but at least I knew the man who was saying what went on, the guiding light in the company.

Q. Now, Mr. Morgan was not a director or an officer of this company as you are aware, isn't that correct? He did not appear to be a shareholder. Did you believe him to be a shareholder?

A. I thought that he was going to be one, actually.

Q. And was it understood that Aurora would borrow moneys from time to time as required from Atlantic, would lay out these moneys in connection with their leases and give Atlantic the pledge of the indebtedness under the lease?

A. Well, I am not sure whether that was understood at first. First, as far as I understood, we were going to raise money for the financing, but that did develop over a period of a year, I suppose.

Q. Yes. Why did you consider that Mr. Morgan was effectively making the decisions and effectively managing the company?

A. Well once again it is hard to say what I know now and what I knew then, but if anybody—only when Laidlaw was appointed, I thought he had some influence, although he told me later he did nothing, he made no decisions, so it—this may be, unfortunately an impression that I have got, that I am not sure that I had then, but I know that if you went to Mr. Morgan, and I was quite satisfied to know that he was sort of keeping an eye on everything, I could put it this way, so in other words, he was taking the responsibility of it. He had come forth with the idea, he had promoted it, it was his baby to make grow and prosper.

Q. What motive did you attribute to him for wanting to make Aurora grow, being neither officer, director nor shareholder?

A. Well, as I say, I think I had the impression at first that he was a shareholder in Aurora, or else somebody in his family was.

Q. And did you retain that impression throughout?

A. I think so. I think I was surprised when I read that he had not any shares himself.

Q. He had no apparent interest, Mr. Gregory, there were shares held through a series of nominees, but he appeared not to be a shareholder. Yourself and British Mortgage had originally 30% of the equity, and later something over 35%. Was there any discussion at any time about you having the right to nominate someone for the board of directors?

A. No, although there was a stage when I was getting a little—well, not dissatisfied, I was not happy with the way things were going and Mr. King was not happy either."

The "Secured Notes" of Aurora Leasing: Carl Solomon as Trustee

The extent of Gregory's knowledge of what was going on in the offices of Walton, Wagman & Co. in connection with Aurora Leasing Corporation will be returned to again, but in any event British Mortgage & Trust lent this company substantial sums of money beginning in 1963.

A letter from Gregory, dated January 3, 1963, to C. P. Morgan¹ has already been quoted in Chapter VIII and may be repeated here:

"Dear Powell:

Re: Aurora Leasing Corporation Limited

I am enclosing herewith our cheque for \$250,000 representing a three-month loan at 7% to Aurora. This loan is to be secured by a 125% collateral to be placed in the hands of Carl Solomon as Trustee for us.

Very best regards for the new year.

Yours sincerely,

"Wilf" "

On January 4 the general ledger of Aurora Leasing² recorded the receipt of this loan, enabling it to lend \$224,400 to Commodore Business Machines with which that company purchased its interest in Analogue Controls.³ Aurora received the security of the Analogue shares and a note from Commodore Business Machines for \$224,402.50, the original of which was found in Carl Solomon's files.⁴ A receipt was also found indicating that Solomon received on January 7 a note of Camerina Petroleum made payable to Aurora Leasing for \$150,000 at 8½ % per annum, to be held as additional collateral security for the British Mortgage & Trust loan, and a letter dated January 29 to Aurora Leasing from Solomon, Singer & Rosen apparently returned this note, which was dated November 6, 1962, and asked for a replacement. The letter reads in part:⁵

"This note was originally given to me to hold as Trustee for British Mortgage and Trust Company as collateral security for a loan of \$250,000.00 made to the said Aurora Leasing Corporation Ltd. It is understood that the note enclosed will be replaced by another note of equal value."

Immediately adjoining the Commodore Business Machines note in Solomon's file was found a receipt, for signature by him, asserting that as at January 7, 1963 he held the note as trustee for British Mortgage & Trust and as collateral security for the same loan.⁶ On the letter there is an acknowledgment of the receipt of the Camerina Petroleum note, signed for Aurora by Harry Wagman, but nothing in the file to indicate that a new note was delivered to Solomon. Thus, briefly, between January 7 and January 29, Solomon evidently held, as security for the British Mortgage loan to Aurora of \$250,000, notes made payable to the latter for

¹Exhibit 2393.

²Exhibit 929.

³Chapter VIII, p. 421.

⁴Exhibit 851.1.

⁵Exhibit 846.1.

⁶Exhibit 851.2.

\$374,400. Thereafter he held only the Commodore Business Machines note for \$224,400.

British Mortgage & Trust made another loan of \$250,000 to Aurora Leasing on January 30, 1963, so that by the end of the month \$500,000 had been advanced on the assumption that Solomon was to hold "security" of at least 125% in value of the amount loaned. A revelation of what was known in Stratford about these transactions is provided by a letter found in the trust company's files dated May 8, addressed to Wilfrid P. Gregory, Q.C. and signed for Aurora Leasing by J. C. Laidlaw, reading as follows:⁷

"On April 3rd, 1963 we forwarded to you a note dated April 4th 1963 for \$250,000 renewing for 90 days our previous note of January 4th, 1963. We requested that you return the January 4th note. To date we have not received it. Could we have this returned at your earliest convenience.

You are holding a note dated January 29th for \$250,000. Would you please advise us of the due date of this loan."

Opposite the first paragraph are the words, in J. D. Gordon's handwriting, "not found", and below the second is his observation, "No note held, no date known". Gordon said in his evidence that he knew nothing of the Solomon trusteeship and, since British Mortgage & Trust had no ledger records nor any note in its custody at the time, he could not understand "what they were driving at".⁸ Aurora Leasing was very slow in delivering notes and Gordon's impression was that "the management wasn't always full time" and that "Aurora was something of a holding company, that it wasn't a very active company". On April 3, according to a receipt given to him by Aurora,⁹ Solomon's trusteeship was fortified by a note from N.G.K. Investments in favour of Aurora, dated January 31, for \$435,000 payable on demand, bearing interest at 8%, and signed for the maker by C. P. Morgan as president. This might have been regarded as restoring the situation had the note been endorsed by the holder, but such was not the case. Although Solomon's receipt contains the phrase "which note is to be held by me as trustee for British Mortgage & Trust Corporation as collateral security for a loan of \$250,000"—and he might well have said for \$500,000 at this point—no letter in any part of the files, Solomon's, Aurora's, or those of British Mortgage & Trust, reporting to that company on the security which he held, has ever been found.

The executive committee of British Mortgage & Trust, according to the minutes of its meeting held on December 18, 1962 and January 29, 1963,¹⁰ approved of the purchase of 7% "secured notes" of Aurora Leas-

⁷Exhibit 4347.

⁸Evidence Volume 119, pp. 16201-5.

⁹Exhibit 851.3.

¹⁰Exhibit 112.

ing Corporation for \$250,000 each, dated January 4 and January 30, 1963. Then on May 8, 1963 a further request was made by Aurora to British Mortgage for another loan of \$250,000 "with the usual security". This money, according to the Aurora books, was received on May 13 and the loan was authorized by the executive committee on the following day under the heading, "Purchase of a note of Aurora at 7% for \$250,000". No additional security was lodged with Solomon or with the trust company, and the former at this point held as trustee security with a face value of \$659,400 in respect of loans amounting to \$750,000. Section 139(4)(b) of the Loan and Trust Corporations Act had in consequence been flouted, in letter as well as in spirit, since it required that the market value of securities held as collateral should exceed the amount of a loan by 20% of that market value. Even if the N.G.K. Investments note, otherwise unsecured, could be said to have had a market value equivalent to that on its face, and even had it been endorsed and thus made negotiable to Solomon, the amount of the loan was much in excess of the purported value of the security and no attempt was made thereafter to repair the breach of this section.

At this point the evidence of Wilfrid Gregory must again be resorted to, to carry further the record of his knowledge and understanding of the operations of a company to which he authorized the lending of a very large amount of money.¹¹

"Q. Ultimately British Mortgage and Trust loaned substantial sums to Aurora, did it not?

A. That is right.

Q. Something in the order of \$1,800,000?

A. \$1,850,000, I believe, or something like that.

Q. And those loans proved to be in large part unsecured, did they not?

A. They proved to be that, yes. They were not supposed to be that.

Q. The ability of Aurora to pay would depend, I suppose, upon the quality of its receivables?

A. Yes.

Q. In making those loans to Aurora, what inquiry did you make into what the receivables of Aurora were?

A. Well, shall we say—let me see, in 1961 Aurora made \$35,000, is that the right year? It may be 1962.

Q. In 1961, according to the statement prepared by Walton and Wagonman, the net profit for the year was \$15,453.52. In 1962, the net profit for the year, according to the same auditors, is \$35,673.77.

A. Yes, well, it was at that stage that I made the first loan to Aurora.

Q. Your first loan was the 4th of January, 1963, I believe?

A. Yes, that is right, the 4th of January, 1963, and I was told the company was doing extremely well, and I had every reason to believe it, and we were told, as I requested, that we would be given security to the extent of 125% of the amount loaned, which gave me an extra 5% margin over what we had to have.

Q. My question was really directed, Mr. Gregory, to this matter, the principal assets of Aurora were as one might expect, receivables. When you made these loans did you inquire of Aurora from whom these sums, amounting to some millions of dollars, were receivable?

A. Well, actually I thought they were not receivables as much as equipment, that this was the assets of Aurora and—

Q. You attended annual meetings, I believe, did you not?

A. I attended a couple of them, yes.

Q. And you would look at the statements received from time to time?

A. I looked at them all right.

Q. Let us take, in fairness to you, the statement just prior to the first loan of Aurora, this is the annual statement as at 31 December, 1962, Exhibit 292.

A. Except I would not have made that when I made the first loan.

Q. All right.

A. I probably saw how things were getting along.

Q. Let us take the statement at the end of 1961, Exhibit 291, if you would look you will see that they consist of term accounts receivable, \$1,182,000, notes receivable, \$1,424,000, interest receivable, \$16,288, equipment class 8, less accumulated depreciation, \$539,000, and equipment class 10, \$15,295. Is that correct?

A. That is correct, yes.

Q. So something in excess of two and a half million dollars out of a total assets of \$3,200,000 appear to be accounts receivable, do they not?

A. They do, hm,mmm.

Q. Did that cause you to reflect, that before making a loan to Aurora, you would want to know from whom those sums were receivable?

A. Well, Mr. Shepherd, maybe I should have, but I told you what happened, which is why we are here, Mr. Morgan called me up and said, 'I would like to have Aurora borrow a quarter of a million dollars for three months, we are doing well, lots of assets', etc. I said, 'Well, I have got to have 125% of securities as a margin, and held by a trustee.' This is what I required and Mr. — and I said the rate of interest to be 7%, which was about what we were getting in mortgages and considerably high for short term money and this would counteract the risk. I felt, and I had confidence in Mr. Morgan, and he said, 'Well, will Carl Solomon do as trustee under these circumstances', and I think I had

been at one meeting in Mr. Solomon's office, he is head of a three-man firm, in the Bank of Nova Scotia building and seemed a very competent and reliable sort of person and I said, 'Yes', and so he—and so I made the loan.

Q. I will undertake to deal with that loan, and others of a like nature in some considerable detail, but may I take that whatever you should have done, or should not have done, you say the fact is that you did not know the identity of the corporations firms to which Aurora was lending money, and from which those receivables arose?

A. That is right, I did not know.

Q. The facts are, Mr. Gregory, as appeared in evidence, that shortly after Aurora was acquired by new owners, it executed a general assignment of its book debts to Commodore Sales Acceptance, which had the registration been valid, would have afforded Commodore Sales Acceptance a reasonable measure of security. Did you become aware therefore—were you satisfied that Commodore Sales Acceptance, which of course is Atlantic, was at least purported to be secure in respect of its money to Aurora?

A. I knew nothing about this particular assignment of book debts until Mr. Farlinger told us, and I must admit I was startled because I felt that was the worst evidence I had up to that time of straight carelessness about my interest, to say the least, and on the reports I noted from time to time that it did show secured notes.

Q. Yes.

A. And this aroused no perturbation or concern in my mind. I thought, 'Well, we are covered'.

Q. Let me direct your attention to Exhibit 293, this being the financial statement for Aurora for 31 December, 1963. If you would be kind enough to look at the notes to the financial statement, note 4 reads:

'Notes payable are secured by a general assignment of book debts'.

Do you recall whether you observed that note to the financial statement, when perusing that statement after it had been published?

A. No, I don't recall it, I am afraid, whether I saw it, it did not make any impression, or whether I did not read the notes.

Q. You would agree that if there were outstanding a valid general assignment of book debts that Aurora could not pledge its receivables as security, is that correct?

A. That is right. That is the first thing I have seen that might have made me aware of something, if I had seen it and noted it. I am wondering if I ever did get the notes to the financial statement, but that is a funny thing to say, I would have thought.

Q. One sees on the balance sheet itself an entry against notes payable, 'secured note 4'. One would think that you would either get these notes, or demand to get them, isn't that correct?

A. Yes, hm,mmm.

Q. Yes. Then, are we this way, is it your understanding that Aurora is in the leasing business, and the policy decisions are being made by Mr. Morgan, and you had the impression that Mr. Morgan was a shareholder, is that correct?

A. This is correct.

Q. And you remained under that impression until what I will call the end, is that right?

A. Yes, until I found out through some evidence.

Q. So as far as that is concerned, on the balance sheet, the principal assets appear to be as to the greater amount receivables. If you saw it, you did not consciously allude to it or have it rise in your mind questions about whether that company was in the leasing business?

A. You see, on December 30, 1963, when we would have 750,000 out, they had 1,337,000 in equipment. Now, I don't suppose, and I don't recall ever specifying what type of security had to be against these loans. As I say, it seems very silly to say it now, but I had such complete confidence in Mr. Morgan that I am afraid possibly I did not look into it as carefully as I should have.

Q. Now on that statement, the one to which you refer, that being Exhibit 293, I notice that the company purports to have \$10,800,000 in assets, of which \$1,693,000 are term accounts receivable, \$2,400,000 are notes receivable, \$5,045,000 call notes receivable, \$129,000 chattel mortgages receivable, whereas the equipment which one might normally expect to be attributable to the leasing business amounts to something in the order of 13—correction—\$1,348,000 or just over 13% of the assets, is that correct?

A. That is correct.

Q. May I take it that although you saw the statements you did not really apprehend from an examination of the statements that this was not a leasing company?

A. I hate to admit it, but I guess that is the situation.

Q. I see.

A. Although I still—I am not an accountant, as you know, but isn't there—can't it be written up that way and still be a leasing company?

Q. Notes receivable? I should think it would be unusual.

A. What if you owed money for—

Q. It would be a payable. . . .”

There can be little doubt that even the strongest financial institution could barely survive such confessed ineptitude as this. But the sympathy that is usually engendered by candour can only with difficulty be maintained against recollection of the obstinacy, verging on arrogance, with

which the witness defended the company's investment in the "secured notes" of Aurora Leasing Corporation in his correspondence with the Registrar of Loan and Trust Corporations and his examiners. Making every allowance for the fact that he was not an accountant and appeared to be, for a lawyer, strangely ignorant of the simplest elements of accounting, the acquiescence by Gregory in Morgan's selection of Solomon as a trustee is sufficiently strange to invite suspicion. For a lawyer of experience and a member of the governing body of the legal profession in Ontario, presiding over the affairs of a trust company which acted as custodian of the savings of many members of the public, to repose such confidence in a young and untried practitioner, not five years out of his law school, on the sole recommendation of a borrower is an action difficult to explain as simply imprudent. Evidence of all other witnesses whose testimony was relevant makes it plain that none of the directors knew about the arrangement with Solomon, and I accept the evidence of Gordon that he, in his capacity as custodian of the company's security, knew nothing of it either. As for Solomon, who had acted on both sides of a transaction before, his failure to furnish his beneficiary with any report upon the state of the security against which very large sums were being advanced does nothing to dissipate the general atmosphere of concealment.

The Loan to Aurora Leasing of \$1,200,000

The fourth loan recorded in the Aurora Leasing notes payable ledger account with British Mortgage & Trust was made on December 23, 1963 in the amount of \$1,200,000. This loan was considered by the directors in their meeting of December 17,¹ held just before the annual meeting of shareholders. Under the heading "Collateral Loans" the minutes, already quoted in part in Chapter IX,² read as follows:

"The Managing Director advised that Mr. Powell Morgan has made inquiries of our interest in two short loans.

\$1,200,000. is required until August 31, 1964 on security of 7,088 shares Camerina Petroleum which stock is priced at \$1.95, which gives the proper value to justify the loan under the Loan and Trust Corporation Act. It is assumed that the loan will be made to Aurora Leasing. The interest rate is 7%.

\$1,200,000. is required by Lucayan Holding Limited. This Company controls property in the Bahamas which is leased to Canadian Industrialists (one of which is E. P. Taylor) at a rental of \$750,000 per annum. The funds would be used to purchase a deposit receipt at 4% maturing March 31, 1964. Associated Canadian Holdings, a Company related to Lucayan will borrow on the security of our deposit receipt

¹Exhibit 109.
²p. 531.

plus shares of Lucayan Holdings. There will, therefore, be no actual cash change hands but we will pay 4% on \$1,200,000. and receive 7% on the same amount.

The Committee approved both loans and left the details for the Managing Director to complete."

There were in fact 787,000 shares of Camerina Petroleum pledged as security and the reference in the minute to 7,088 must be a typographical error. The Aurora notes payable ledger indicates that the loan was due September 19, 1964 and in fact bore interest at $7\frac{1}{4}\%$; it was repaid, according to the same record, on August 31, 1964. Given a market value of \$1.95 for the Camerina shares there was sufficient security, but the provisions of section 139(4)(b) go on to say that the amount loaned on the security of the stocks of any company must not exceed 10% of the market value of its total outstanding stocks. At the date of the loan there were 1,900,000 shares of Camerina Petroleum outstanding and, the total market value of these being in the neighbourhood of \$3,800,000, the loan was about three times as large as it should have been. The books of Aurora Leasing show that earlier in the year, on March 19, it made a loan to Cushing & Co., another street name for the Lambert firm in New York, of \$1,350,000, bearing interest at $7\frac{3}{4}\%$ per annum, against the security of the same Camerina shares. Having on December 23, or eight months later, received \$1,200,000 from British Mortgage & Trust, it paid this sum over to Commodore Sales Acceptance, thus reducing its debt to that company at the year-end. Cushing & Co. paid its debt to Aurora on August 31, 1964 and on the same day Aurora repaid British Mortgage & Trust its loan, with interest at $7\frac{1}{4}\%$ for 252 days. Aurora had surrendered its security to British Mortgage & Trust for a loan \$150,000 less than what it had lent to Cushing & Co. and was accordingly unsecured in respect of that amount, but received the benefit of one-half of 1% of \$1,200,000 for the period during which the loan from British Mortgage & Trust was outstanding.

A remarkable feature of these two loans for \$1,200,000, apparently approved by the directors a few hours before they presented themselves to their shareholders for re-election, is that they were not recalled by any of members of the board examined except W. P. Gregory himself. Present at the meeting on that day, according to the minutes, were W. H. Gregory, W. P. Gregory, H. W. Baker, A. B. Manson, H. B. Kenner, J. R. Anderson, S. K. Ireland, J. M. Armstrong, and W. A. Pike. Of these, at the time when evidence was taken before the Commission, Baker and Manson were dead and Pike in prison; W. H. Gregory was not examined. Ireland, to whom the minutes in relation to both these loans was read by counsel, said he had no recollection of them and had never heard of any company with the name "Lucayan" until he read about it in

the paper after the collapse of Atlantic, and he concluded his evidence on the point as follows:³

“Q. Are you satisfied, Mr. Ireland, that although that passage occurs in the minutes, that that matter was not discussed with the board of directors?

A. I have no recollection of ever hearing of it, let alone hearing any discussion.

Q. Do you recall the loan referred to in the first paragraph of that passage, the loan of \$1,200,000 on the security of Camerina Petroleum shares?

A. No, I do not.”

Dr. Kenner bluntly denied that he had ever heard of either of the loans prior to the time of giving his evidence to the Commission.⁴ Armstrong, who was not then a director, but was recorded as having been present in his capacity as assistant general manager, had this to say on the subject:⁵

“Q. Did you hear read the passage from the minutes of a directors’ meeting said to be held in December, 1963, referring to a loan to Lucayan Holdings Limited, or a loan in connection with Lucayan Holdings Limited, a loan in connection with certain shares of Camerina Petroleums Limited?

A. Yes, I heard that read.

Q. Can you say whether any such loans were disclosed to the directors or discussed in their presence, to the best of your recollection?

A. To the best of my recollection that was not discussed in my presence.

Q. Neither one of them?

A. Neither one, sir.”

Finally John R. Anderson, general counsel for the company, who testified that he and Armstrong generally sat side by side and that he was frequently prompted by the latter to question the eligibility of individual investments, was asked the same question.⁶

“Q. One last thing. I read to Mr. Ireland this morning, and I believe it was in your presence, a passage from the minutes in December, 1963, wherein reference is made to approval by the board of directors of a loan of \$1,200,000 to Lucaya Holdings Limited, and a further reference to a loan of a like sum on the security of shares of Camerina Petroleum. Can you tell us whether to your recollection either of those loans was in fact discussed with the directors?

Evidence Volume 117, p. 15980.

Evidence Volume 117, p. 16114.

Evidence Volume 117, p. 16097.

Evidence Volume 117, pp. 16081-2.

A. I have no recollection, sir, of either of those loans. I am certain in my mind that the name 'Lucayan', which I now associate with the Bahamas, first came to my attention after the collapse, and that other name of the petroleum company—

Q. Camerina?

A. Camerina just does not register with me at all, so I have no recollection of it."

One other feature of the minutes of this meeting is that they conclude with the words: "The committee approved both loans and left the details for the Managing Director to complete." The meeting was not, of course, one of the executive committee but of the board of directors, and one might think at first glance that this was an example of confusion in the records. A meeting of the executive committee was indeed recorded as having been held on the same day at 1.30 p.m., immediately before the annual meeting, and no reference to these loans was included in its minutes. None the less Anderson, Kenner and Armstrong are all reported as having been at this meeting of the committee. I can only conclude that the question of making these two loans, amounting in the aggregate to \$2,400,000, was never submitted to either the board of directors or the executive committee, since it is inconceivable that loans of this magnitude, connected with companies the names of which were novel and indeed invited inquiry, could have been forgotten by witnesses whose evidence, given under oath and in my presence, I regard as being true. The responsibility for these minutes, containing an assertion that the loans were approved by men who had never heard of them, lies heavily on the shoulders of Messrs. W. H. Gregory and Pike who signed them, and upon those of Wilfrid P. Gregory who acted upon an authorization which he knew to be fictitious.

Loans to Aurora Leasing in 1964 and 1965: the Belfield and Tip Top Tailors Mortgages

By the end of 1963, therefore, the total amount lent by British Mortgage & Trust Company to Aurora Leasing Corporation on which no repayment of principal had been made was \$1,950,000. In 1964 two further loans must be briefly looked at, and will be referred to again, because they are part and parcel of the trust company's mortgage lending transactions, but were obtained by Aurora only on the security of promissory notes. The first was an advance of \$850,000 made on February 29 due for repayment, of course, on October 29 and bearing interest at $7\frac{1}{4}\%$ per annum, to enable Aurora to participate in the financing of a number of buildings in the Rexdale area of Toronto, each owned by a separate company which was in turn affiliated by common directors with Belfield Investments Limited. The activities of these companies and of

their promoter, Roy G. Calladine, must be dealt with in considerable detail hereafter. Suffice it to say that, by the time \$850,000 had been advanced to Aurora on February 29, British Mortgage & Trust had lent to these affiliates of Belfield Investments, by name 50 Belfield Road Limited, 60 Belfield Road Limited, Indus Investments Limited, Surpass Investments Limited and Trans-Dallas Investments Limited, a total of \$2,996,416 by way of first mortgages for \$3,290,000 on properties valued by L. W. Facey, the trust company's Toronto mortgage manager, at \$5,440,000.¹ These loans were then within the limit of two-thirds of the ostensible value of the property securing them prescribed by the Loan and Trust Corporations Act, but Calladine needed more money. Wilfrid Gregory had approached C. P. Morgan, evidently at the Royal York Hotel in Toronto, as indicated by a letter dated January 27, 1964 to the latter from Facey, a copy of which was sent the same day by Facey to Pike in Stratford.²

"Dear Mr. Morgan,

re Belfield Investments Limited — and Aurora Leasing Limited

We are now ready to proceed with the mortgage financing for Belfield Investments Limited that was discussed at the meeting with our Mr. W. P. Gregory, at the Royal York Hotel about two weeks ago.

The amount required from Aurora Leasing Limited is \$850,000, and the security will be five large industrial buildings in Rexdale, owned by Belfield Investments Limited, even though they are held by separate companies, all of them are wholly owned by Belfield Investments Limited.

This will be a blanket mortgage which will in fact, be a second mortgage on 50 Belfield Road-60 Belfield Road, and the Transdallas building, and a third mortgage on both the Indus and Surpass Buildings.

The proposed mortgage will be for \$850,000 at 10% interest for five years, repayable on a twenty-year amortization plan, \$8,089.11 monthly. Repayment privileges will be—

1. Two months interest bonus to discharge the various amounts allocated on each property to be calculated on the amount to be paid off (and covered later in this letter) during the first two years.
2. After two years, the privilege to pay any herein specified amount off principal on any payment date without notice or bonus.
3. The privilege to pay up to \$250,000 off principal and obtain release of the Transdallas building upon payment of one month's interest bonus (calculated on the amount paid off) should the existing tenant exercise their option to purchase the property during 1964.
4. Should any privilege of prepayment be exercised, the monthly payments on the outstanding balance will then be reduced accordingly.

BRITISH MORTGAGE & TRUST

The amounts allocated to each individual property for discharge purposes will be as follows:

50 Belfield Road	\$ 75,000.00
60 Belfield Road	300,000.00
Indus building	85,000.00
Surpass building	140,000.00
Transdallas building	250,000.00

These amounts were determined by calculating the ratio according to the income stream.

Aurora Leasing Limited will postpone to the following amounts:

50 Belfield — a first mortgage to British Mortgage and Trust Company for \$550,000.

60 Belfield — a first mortgage to British Mortgage & Trust Company for \$900,000.

Indus Building a first mortgage to British Mortgage & Trust Company for \$532,000, and

a second mortgage to the Vendors of the land for a blanket mortgage of \$190,000 which also covers Surpass.

Surpass Building a first mortgage to British Mortgage & Trust Company for \$508,000, and a second mortgage to the Vendors of the land for a blanket mortgage of \$190,000 which also covers Indus building.

Transdallas—a first mortgage to British Mortgage & Trust Company for \$800,000.

The funds supplied will be used to discharge the second mortgage of \$400,000 held by Coronation Credits Limited, the \$250,000 second mortgage held by Clarence Frances O'Neill and provide Belfield with capital to pay for the addition of 68,000 square feet now under construction on 60 Belfield Road, with the balance to pay for an addition of 20,000 square feet to 50 Belfield Road, plus any legal fees and bonuses for discharge, etc.

Belfield Investments Limited can accept your funds at any time now, therefore, your solicitor, Mr. A. M. Ecclestone of Messrs. Shuyler & Ecclestone, 320 Bay Street, Toronto, has been advised of the above mentioned terms by copy of this letter. He is fully conversant with the entire Belfield situation and is awaiting your instructions to prepare the mortgage. Would you, therefore, kindly contact him at the above mentioned address, or if you wish to telephone, the number is Em 3-6203.

Yours very truly,
'LWF' "

Mr. Ecclestone, who was already acting for British Mortgage & Trust, now had a second client whose arrival on the scene was clearly designed to permit British Mortgage & Trust once again to circumvent section 139(4)(aa) of the Loan and Trust Corporations Act. Leaving aside for the moment the face value of the mortgages taken by it from the Belfield

companies, the actual sums advanced to them at this point amounted to \$2,996,416, which, with the vendor's second mortgages on two of the properties and the second and third mortgages taken by Aurora Leasing, amounted to 74.3% even of the valuations made by Facey which could hardly be described as independent. The practice of trust companies combining with other corporations to lend up to 80% of the apparent market value of a property was common in the industry and can be regarded as an evasion rather than a contravention of the statute. The peculiar vice of this arrangement with Aurora was its participation made with money lent to it directly by British Mortgage & Trust for the purpose, secured only by a promissory note and allowing it the benefit of a spread in interest of $2\frac{3}{4}$ % per annum. Wilfrid Gregory, when Facey's letter to Morgan was put to him in the course of his evidence before the Commission, gave the following explanation:³

"A. Yes. Mr. Facey, once again through Mr. Pike, let it be known that they needed some second mortgage financing in connection with some of these Belfield loans. They had a couple with Coronation, I believe, or some similar company, with whom they weren't satisfied. I suggested to Mr. Pike he tell Facey to see Mr. Morgan, that possibly he had some method of doing it. Then, eventually, it developed—In fact, I think it was my suggestion that if they wanted to put them into Aurora we would lend Aurora the money on secured notes and Aurora, in turn, would lend the money to Belfield on these second mortgages.

Q. Did you have some conversation with Mr. Morgan on the matter, as suggested in that letter?

A. Yes. After a preliminary discussion between Mr. Facey and Mr. Morgan we got together and settled the details.

Q. And the evidence before us is to the effect that British Mortgage loaned this money to Aurora at $7\frac{1}{4}$ per cent?

A. About that, yes.

Q. And Aurora loaned the money to Belfield?

A. At 10 per cent.

Q. Yes. But, British Mortgage & Trust did not get any security from Aurora. Can you assist us as to how that happened?

A. Well, that was the—to be a normal financing with Aurora, where we were to obtain 125 per cent and through our—what should you say, just a mistake of our staff, they never got the security. They got the note but it wasn't a secured note. Mr. Solomon, who was the trustee, and from whom they expected it, didn't provide it. I guess he wasn't asked specifically to provide it, but Mr. Morgan knew the terms on which we loaned to Aurora, which was first set down, and which called for 125 per cent of security.

³Evidence Volume 116, pp. 15845-7.

THE COMMISSIONER: This is an assignment of receivables of Aurora's up to 125 per cent—

A. That is right, sir.

Q. —of the value?

A. That is right."

Gregory went on to say that Morgan, in discussing security for this loan, told him on the telephone that he would see that security was given to British Mortgage & Trust. In Gregory's words:

"He said, 'I don't think I will simply assign these mortgages to you, but I will see that there is security for you', so in my mind it was looked after".

The other loan made to Aurora Leasing Corporation in connection with a similar transaction, also on February 29, 1964, was for \$100,000 and was incidental to a large mortgage loan made by British Mortgage & Trust Company, also authorized by its directors on December 17, 1963, in the amount of \$500,000 for ten years at 7½ % per annum, to be secured by first mortgage from Tip Top Tailors Limited on that company's head office and manufacturing building on Lakeshore Boulevard in Toronto. On January 2, 1964, Tip Top Tailors successfully applied for an increase in the amount of the loan⁴ to \$1,000,000 for the same term at 8½ % per annum. The original application was accompanied by a three-page memorandum from G. D. Bowman of the Toronto office of British Mortgage & Trust⁵ quoting a "detailed market appraisal" by W. H. Bosley & Company, a well-known firm of real estate brokers and valuers, to the effect that the building and lands would sell at a price between \$900,000 and \$1,275,000, depending upon the required use. Bowman felt that a valuation of \$1,000,000 would be reasonable, warranting a loan of "\$500,000 or even \$600,000". When the second application for double the amount of the original loan requested was forwarded to Stratford it was accompanied by another memorandum from Bowman to Pike⁶ containing the following artless comment:

"You will note in the original application that I placed a value on the property of not less than \$1,000,000 because that amount was required for recommending the \$500,000 loan, but for the purpose of the \$1,000,000 mortgage required, I value the property at \$1,500,000."

Bowman went on to recommend an independent appraisal and to say that he had commissioned one from "Mr. Ace Duncan of Canada Trust Company". A. C. Duncan, then Toronto mortgage manager of that

⁴Exhibit 4425.

⁵Exhibit 4417.

⁶Exhibit 4423.

company, obliged by producing a letter of opinion dated January 10, 1964,⁷ in his capacity as "an appraisal consultant" carrying on business at his residence, asserting that the market value of the Tip Top Tailors' property was in fact \$1,700,000 of which \$1,000,000 was attributable to land value. Although these details are not strictly relevant to the loan made to Aurora, they are interesting as an illustration of the quality of the work of British Mortgage's valuers of which Wilfrid Gregory was inordinately proud and which was a matter of concern to the Registrar's examiners. Although a valuation had now been secured under which British Mortgage & Trust could lend \$1,000,000 as a sum not in excess of two-thirds of the market value of the mortgage security, section 142 (1) (a) (ii) of the Loan and Trust Corporations Act stood in the way of total investment in any one company maturing in more than one year, including the purchase of its stock or other securities and the lending to it on the security of its debentures, mortgages or other assets or any part thereof, of an amount exceeding 15% of its own paid-in capital stock and reserve funds, which at October 31, 1963 was calculated to be \$903,411.⁸ In consequence there was a deficiency of \$96,589, making it necessary to bring in another lender as participant. Aurora Leasing Corporation was again resorted to, and a certificate and declaration of trust (described as an agreement on its back, but not executed by Aurora) was signed on February 26, 1964, by W. H. Gregory and W. P. Gregory, to the effect that it was the mortgagee for \$1,000,000 from Tip Top Tailors Limited and that it held in trust for Aurora Leasing Corporation Limited \$100,000 "which it received from the said Aurora Leasing for investment in the said mortgage on the following terms and conditions"; these included the proviso that the British Mortgage investment of \$900,000 should rank ahead of the Aurora investment of \$100,000, that British Mortgage would pay Aurora interest at the rate of 10% per annum and that it would also pay it "such amounts on account of principal as may be feasible from the accumulated monthly payments due under the said mortgage". Again funds for Aurora's participation were lent to it by British Mortgage & Trust for which it took a note expressed to be due October 29, 1964, as in the case of the Belfield advance conveniently before the year-end, and again Aurora received a net of $2\frac{3}{4}\%$ per annum for thus accommodating the trust company. Better yet, it received as repayment all the principal repaid to British Mortgage by Tip Top Tailors on the due dates of September 1, 1964, and March 1, 1965, amounting in the aggregate to \$24,000, without making any payment on its note to the trust company at any time between then and the date of its own bankruptcy on July 30, 1965. Wilfrid Gregory's explanation of this transaction revealed no appreciation of the monetary penalties paid by his

⁷Exhibit 4424.

⁸Exhibit 4293.

company in order to circumvent the provisions of the statute and some confusion about the nature of what was done.⁹

"Q. There was another loan recorded on the books of British Mortgage & Trust to Aurora which I have not yet referred to, this being \$100,000 which arose out of mortgage transactions whereby British Mortgage took a mortgage of \$1,000,000 from Tip Top Tailors and then recorded that \$100,000 was loaned to Aurora, and Aurora loaned it back for the purpose of taking a ten per cent interest in that mortgage?

A. That is correct.

Q. Can you state now how this matter arose?

A. Well, it was an excellent loan, but it was a little more than we could take. So we said, we will have Aurora take the second mortgage. It will be a good investment for them and we will let them have the money in the meantime and we know the security they have.

Q. More than you could take in the sense that it was a prohibition in the Act?

A. At that time I think our limit was about nine hundred and some thousand dollars. We couldn't go the million.

THE COMMISSIONER: That was the reason, was it, for holding this money in trust for Aurora? Isn't that the way it was done?

A. I think it was, the detail, I think, they wanted to try and keep control of it, as it were, at that time, and it didn't work out as well as they had hoped from that point of view, because we owed the money to Aurora and couldn't get it back, but as far as the loan is concerned, the mortgages were good and we were getting quite a nice return on the whole thing."

The repayment of \$1,200,000 with interest by Aurora to British Mortgage & Trust on August 31, 1964 reduced the standing balance of loans payable to \$1,700,000, but one last loan was to be made under the guise of purchase of secured notes. This amounted to an advance of \$160,000 on March 1, 1965 which was also connected with the trust company's heavy commitment to the financing of the Belfield buildings two of which, owned by the Belfield Investments affiliates, Indus Investments Limited and Surpass Investments Limited, were still encumbered by a mortgage to the original vendor, standing between the first mortgages of British Mortgage & Trust and the third mortgages of Aurora Leasing. The vendor, Indian Line Investment Limited, which had been showing signs of impatience with the behaviour of Roy G. Calladine, was, at March 1, 1965, owed \$175,000 on principal and interest from May 30, 1964, amounting to \$9,694.39. Aurora purchased this mortgage at a discount and it was assigned by Indian Line on March 1 for the \$160,000 lent to Aurora by British Mortgage & Trust, for which

⁹Evidence Volume 116, pp. 15871-2.

a demand note bearing interest at $7\frac{1}{2}\%$ per annum was given on the same day.¹⁰ Aurora assumed the arrears of interest payable by Indus and Surpass which, by July 30, 1965, had grown to \$13,755.19 and, although paying some interest to British Mortgage & Trust thereafter, received no payments of any kind from the mortgagors. The principal amount of its note to British Mortgage & Trust was still outstanding at July 30, 1965 and raised the aggregate of the trust company's loans to it to \$1,860,000.

Final State of Aurora Security Lodged with Solomon

In the meantime the security lodged with Carl Solomon as trustee had been further eroded. On October 4, 1964, Commodore Business Machines, as recorded in the loan ledger of Aurora Leasing,¹ discharged all its indebtedness by repayment of \$262,362.50. This sum was made up of the note in the amount of \$224,402.50, plus an additional borrowing of \$37,960. Nothing, therefore, was afterwards owing on the Commodore Business Machines promissory note held by Solomon and no correspondence or other documents have been found indicating that either Solomon or Wilfrid Gregory knew it had been repaid, although both of them as directors of Commodore Business Machines could have known. This repayment was not followed by any reduction in Aurora's indebtedness to British Mortgage & Trust. Solomon was accordingly left with a note to Aurora from N.G.K. Investments, not endorsed, for \$435,000 as security for loans from British Mortgage & Trust to Aurora then outstanding in the amount of \$1,700,000, or in effect no security at all in a situation where he was supposed to have receivables amounting to 125% of the amount loaned. N.G.K. Investments, as has been seen,² had purchased in December, 1960 all the issued and outstanding 100 shares of Mavety Film Delivery for the sum of \$256,125, for which it gave Aurora a note bearing interest at 8% per annum. On April 29, 1965 N.G.K. Investments subscribed for the remaining shares in the Mavety treasury for a price of \$24,000, giving it a total of 2,500 shares for an investment of \$280,125. On the same day, in a transaction which Wilfrid Gregory has been seen as resenting, it sold 500 of these shares to British Mortgage & Trust for \$160 per share, receiving a cheque for \$80,000; accordingly, a company of which he was vice-president, director and shareholder, made some \$48 per share profit at the expense of a company of which he was president, managing director, and an even more substantial shareholder. On the following day it sold 1,000 shares to Aurora Leasing, another company in which both British Mortgage & Trust and Wilfrid Gregory together held a 35% interest, quite apart

¹⁰Exhibit 4322.

¹Exhibit 929.

²Chapter V, p. 156.

from the money which the former had poured into its coffers, and received payment of \$160,000 at the same rate. Then on that day, April 30, it repaid \$235,000 to Aurora and on May 3 borrowed \$25,000 from Mavety Film Delivery which it also paid to Aurora, its debt to the latter at that point being reduced to \$165,500. Another repayment of \$2,000 followed in the same month, so that by May 31 the total amount owing on the note from N.G.K. Investments, with a face value of \$435,000, to Aurora Leasing was \$163,500. Thereafter the whole security held by anyone for the benefit of British Mortgage & Trust against loans to Aurora Leasing in the amount of \$1,860,000 was this note, not endorsed, lodged with Carl Solomon, on which \$163,500 was owing together with unpaid interest. The trustee in bankruptcy for Aurora Leasing Corporation has received a claim from Victoria and Grey Trust Company as an unsecured creditor.

It will be recalled that on April 2, 1965 the Registrar of Loan and Trust Corporations had written to the president of British Mortgage & Trust,³ calling his attention to its advances to and investments in Aurora, among other companies, and saying "I will need confirmation that these are authorized investments and that where collateral loans have been made, there is, in fact, an active market". Gregory's reply of April 27⁴ referred to the Aurora situation in these words:

"The loans to Aurora are short term loans based on secured notes of the Company. The security under these notes is at least 125% of the amount owing. There are other holders of similar secured notes but there have not been enough available to build up a wide clientele. We are very pleased to have them available as an investment at 7% involving as it does the double security of the specific asset as well as the credit of the Company."

This statement was clearly incorrect and it is important, at the risk of redundancy, to give a further extract from Wilfrid Gregory's evidence to the Commission on the subject of the Solomon trusteeship and as to what he knew about the nature of the security held.⁵

"MR. SHEPHERD: . . . Is it your recollection that Mr. Morgan asked for a loan of \$250,000, you informed Mr.—for Aurora—you informed Mr. Morgan you would lend \$250,000 to Aurora, but you wanted 125% of that amount lodged as security with Mr. Solomon as trustee. Is that correct?

A. Substantially. I said I needed 125% of security lodged with a trustee and Mr. Morgan said Mr. Solomon of Solomon, Samuel and Singer will be satisfactory, and I said, 'Well, under the circumstances it isn't large, we will accept him'.

³Exhibit 2553.2.

⁴Exhibit 2553.4.

⁵Evidence Volume 116, pp. 15850-3.

Q. Why did you not want the security lodged, as was done in every other case other than Aurora, directly with British Mortgage?

A. With this short term money security is never lodged with us, it is always lodged with a trustee and this is what the Act called for.

Q. This was collateral, wasn't it?

A. No, the Aurora loan I treated just like an Atlantic Acceptance short term loan, where you lend the money for a short period of time and they give you the secured note with collateral lodged with a trustee.

Q. Is that not against the security of the trust deed, such as with Atlantic? What was the advantage here of having your security lodged with Mr. Solomon instead of having it lodged with British Mortgage?

A. Well, I just looked up the Act and it had to be lodged with a trustee.

Q. What section is that, Mr. Gregory? Do you mean you just looked it up now or at that time?

A. At that time.

Q. I see. Well, let me then, see if this is correct, that you read the Act and you considered that if you had this security lodged with a person who would hold it in trust for British Mortgage that that was an advantage under the Act and complied with the Act?

A. Complying with the Act, this is what I wished to do.

Q. You did not consider it necessary to have a trust deed?

A. I didn't think, with the small loan to start with, it was necessary to go to that trouble and expense.

Q. Let us take, for example, the loan to N.G.K. In the case of N.G.K. British Mortgage & Trust loaned money in the order of \$250,000?

A. 240.

Q. \$240,000. And received a pledge of some Commodore Business Machines' debentures, and shares of a market value exceeding 125%. Why did not you follow the same pattern in respect to the Aurora loan?

A. Well, the N.G.K. one came up considerably later and it was just one transaction and that was the way I called that transaction, as it were, and this is the way I asked for and got it.

You see, on this Aurora thing, Mr. Morgan phoned up and said, 'Can you lend us a quarter of a million for three months?' I said, 'Well', I said, 'I will do it at 7% and we have to have a trustee.' This is what was in my mind. And he said, 'Will Solomon do', or, 'I will have Solomon look after it'; and I wasn't as satisfied as if it was one of the trust companies but it seemed reasonable.

Q. You envisaged the lodging of some of Aurora's receivables to the face value of at least 125% of the loan?

A. Some of its assets.

Q. I think we have already been over this yesterday. Was it a fact that you did not know that Aurora had at least purported to give a general assignment of its book debts to Commodore Sales Acceptance?

A. I certainly didn't know that."

Counsel then put to the witness the correspondence with the Registrar and turned to the examination of the trust company's securities conducted by him with a view to giving specific and detailed answers to Richards' questions.⁶

"Q. What were the names of the three persons to whom you have referred in your first letter to Mr. Richards, of the three I have read, members of your staff whom you directed to go and get information?

A. Mr. Pike on mortgages, Mr. Gordon on investments, and Mr. James Anderson, our controller, on general accounting and back-up.

Q. Yes. What enquiry, as far as you were aware, did Mr. Gordon carry out concerning investments?

A. I don't know what actual enquiry he carried out. I went over the letters with them and also with Mr. Armstrong, our assistant general manager, and we went into them very carefully.

They were excellent letters from Mr. Richards and I appreciated getting them, and then we divided the work up and said, 'Now, bring me the answer to all these', and when we got the answers in we went over them, and then I wrote these letters.

Q. I would have thought that when we come to the question of the security for Aurora, that you would expect Mr. Gordon would examine the matter carefully and determine precisely what security it was which was held and reported. Did he do that?

A. I do not recall, but I quite agree with you that you might have expected that. I should have expected it.

Q. Were the auditors called in at all to make any investigation into the matters on which Mr. Richards requested information?

A. I don't think so. I don't—as I say, they made a running audit and they were there every month and I don't know whether any of our chaps referred to the auditors for further information, but everything should have been there at their fingertips.

Q. Who was it who finally reported to you so that you might in turn report to Mr. Richards respecting the investments and, specifically, the Aurora investment?

A. Well, Mr. Gordon, he reported to me on investments.

Q. And did he make his report orally or in writing?

A. Well, I would think he would have notes, but I would go over them orally and we discussed them and I made notes from which I would write the letters.

⁶Evidence Volume 116, pp. 15868-71.

Q. Do you remember what it was that he reported to you with respect to the security for the Aurora notes?

A. I do not. I am sorry.

Q. Can you assist us any more respecting how you came to write the letter referring to the Aurora notes?

A. Well, this is just exactly what I took for granted. These notes—Aurora notes—were issued on the understanding we would have 125% of the security. We had what I thought was a responsible trustee set up and, as far as I knew, everything had been carried out regularly and I had no reason to think otherwise.

This is the unfortunate thing. There is nothing that—nothing sort of tipped me off and possibly if at this time I had gone and said, 'I would like to have a letter from Mr. Solomon', then it would have shown up or if our auditors at any time had asked Mr. Solomon for a letter it would have shown up, but I am afraid that I didn't. It didn't occur to me."

As to his part in providing the information which enabled Gregory to reply to the Registrar's letters, J. D. Gordon had a somewhat different story to tell.⁷

"Q. Well then, there was evidence to the effect that on the 2nd of April, 1965 the Registrar of Loan and Trust Corporations wrote to Mr. Gregory asking for a large amount of information, including information respecting the eligibility of investments in Aurora Leasing Corporation, and the evidence was that Mr. Gregory wrote back to the superintendent and said that three members of the staff had been charged with the responsibility of getting the answers to the superintendent's questions, the Registrar's questions, and Mr. Gregory said that you had certain responsibility in this area.

Do you recall the occasion and can you tell us what you were supposed to do in getting information for the Registrar?

A. I don't recall being instructed to look into Aurora Leasing at that time, and, as I said before, I didn't, I wasn't aware of the Solomon trusteeship, so that I couldn't have verified it and I know, in fact, that I didn't verify it at that time.

Q. What were you asked to do—

A. As I recall I may have—

Q. —in relation—?

A. —supplied them with some information in connection with the real estate held by the company for sale.

Q. And did you do that?

A. Yes, I believe that I did.

⁷Evidence Volume 119, pp. 16205-10.

Q. Then, Mr. Gregory wrote a number of letters to the superintendent setting out very detailed information relating to mortgages and also relating to real estate held for sale and also relating to investments. Did you take any part in the preparation of those letters?

A. In the real estate held for sale, would be the only one where I would contribute some of the information.

Q. Do you know if anyone else was instructed to prepare the necessary information to make answer to the Registrar respecting his inquiries and securities?

A. No, I wouldn't think so. Not to my knowledge.

Q. After January, 1963, how many audits of this company would there have been before the collapse?

A. They were done monthly by alternate auditors. There were two auditing firms so that—and then, of course, a major one at each year-end, which was October 31st of each year.

Q. Do you recall any inquiry being made by auditors or any discussion being had either in respect of the year ending 31st October, 1963, or on the same date of 1964 as to what security the company had for these Aurora loans?

A. I was questioned on a couple of occasions, I believe at least once by the auditors as to the book value—pardon me, market values which I supplied them for certain securities, and since they did not trade very often they were somewhat concerned about them being entirely realistic; and they may have asked me about the Aurora notes as well, but I really did not have much information to give them, I didn't have statements of Aurora, so I would refer them to Mr. Gregory. I assume that they spoke to him about it.

Q. Yes. Who do you consider did obtain the information necessary to enable Mr. Gregory to write back to the superintendent saying that the Aurora notes were secured by 125% collateral?

A. I couldn't say, sir.

Q. Do you know who the other two persons were among the three to whom Mr. Gregory alludes as being persons instructed to make inquiry to get information for the Registrar?

A. I would think Mr. Pike would have given him information with respect to mortgages and I think he probably worked with me on the real estate for sale because he had previously been responsible for that.

Q. Yes?

A. He might have asked Mr. Anderson for some information but I couldn't say for sure.

Q. Well then—

A. Probably with respect to reserves and any financial matters he would have asked Mr. Anderson to give him any exhibits that were necessary.

Q. How would the arrangement be made, step by step, for one of these Aurora loans, and I think all the evidence indicates Mr. Morgan spoke to Mr. Gregory in connection with those loans and, obviously, Mr. Gregory agreed to make the loan. Then, what would be done?

A. Mr. Morgan would handle the Aurora end as far as arranging it. We would never have to contact Aurora directly unless there was some banking arrangement, arrangements for payment or delivery of the loan. Generally the terms and the dates were set up between Mr. Gregory and I assume Mr. Morgan, as was in the first case.

Q. Well then, when Mr. Gregory did tell you to issue a cheque for \$250,000 what was his practice as to the information he gave you about this loan?

A. He would tell me the terms and the interest rate and so that we could set it up in the ledger when the cheque was advanced and the name of the corporation.

Q. And would he tell you about the security?

A. I can't recall him doing so in that case although in the case of a collateral loan he would always do that. Usually in the case of collateral loans we didn't advance the money until we had the collateral.

Q. Well then, on leaving this point, is it fair to say that your understanding was that the company was not making collateral loans to Aurora, it was purchasing an Aurora short term note which was secured in some manner, no doubt essentially similar to the security under the trust deed in respect of the Atlantic notes?

A. That is correct, sir.

Q. And you never did make inquiry about security in the hands of Mr. Solomon because you didn't know there was any security?

A. No, I wasn't aware of it."

British Mortgage & Trust, in its annual statement to the Registrar, reported the Aurora notes at October 31, 1964 as amounting to \$1,700,000, in company with those of Atlantic Acceptance in the amount of \$1,750,000 and those of Granite Investment & Development Limited of \$850,000, under the heading of "Guaranteed Short-Term Notes" totalling \$4,300,000. The term "guaranteed" meant that they were held in the guaranteed funds account as secured and liquid investments. The notes of Atlantic Acceptance and Granite Investment were in fact secured by a trust deed to a trust company. Although Gregory was at pains to say that he took full responsibility for what was done or not done by members of his staff, he made two rather unattractive suggestions in the course of his evidence to the effect that Gordon, who was neither lawyer nor accountant, was the man responsible for failing to apprehend the real nature of the security behind the Aurora notes. These were similar in tone and implication to the suggestion that it was Gordon's responsibility to master the detail of the letter received from Reid,

Menzies and Creighton, reporting to him on July 22, 1964 on the assignment of the note from Treasure Island Gardens to Atlantic Acceptance for \$750,000 and of the interest of the latter in its mortgage of leasehold interest to British Mortgage & Trust, described in Chapter VII,⁸ which he acknowledged as "reporting on this matter in a most complete fashion".⁹ Since Carl Solomon had never corresponded with British Mortgage & Trust about his position as trustee of the security for the Aurora notes, and only Gregory, Morgan and Solomon knew of the arrangement, the attempt to involve Gordon in its consequences was not impressive. I concluded that the whole episode was painful to remember, let alone to explain, and that the Registrar was knowingly misled by Gregory without any intervening negligence, much less knowledge, on the part of Gordon.

* * * *

The Mortgage Portfolio

Evidence about the mortgage portfolio of British Mortgage & Trust Company was given by Mr. Hugh B. Walker of Touche, Ross, Bailey & Smart in very considerable volume, beginning on April 12, 1967 and continuing over five successive days.¹ He was examined initially by Mr. Shepherd and subsequently at greater length by Mr. Cartwright. Any attempt to give a faithful account of this mass of evidence prepared from the files of the company, from its annual statements to the Registrar of Loan and Trust Corporations, and from the report of Peat, Marwick, Mitchell & Co. to Denison Mines Limited in connection with its option to purchase shares of the company, would distort the size and scope of this account. Some information must, however, be examined closely and especially certain disturbing aspects of it. It has already been seen that, under the guidance of Wilfrid Gregory, a very marked expansion of the mortgage portfolio had been embarked upon, characterized by a heavy increase in the number of mortgages over \$50,000 particulars of which had to be given to the Registrar. Mr. Walker prepared a lengthy and detailed analysis of the portfolio, commencing at October 31, 1960 and continuing thereafter until the year ended October 31, 1964, with a supplementary view provided as at July 19, 1965 by Peat, Marwick, Mitchell & Co. It is entitled "Summary of Advances of Principal Against Security of Mortgages, Leaseholds and Real Property, as at October 31, 1960 to 1964 and July 19, 1965" and may be found at Table 74.² The mortgage lending of trust companies was prescribed and limited by the provisions of section 139(1) and (4) (*aa*) of the Loan and Trust Corporations Act, the essence of which

⁸pp. 257-8.

⁹Exhibit 1474.

¹Evidence Volumes 110-4.

²Exhibit 4351.

is that they may lend their own funds and funds entrusted to them by deposit and for guaranteed investment on the security of real estate or leasehold of real estate, provided that "the amount of the loan, together with the amount of indebtedness under any mortgage, charge or hypothec on the real estate or leasehold ranking equally with or superior to the loan, shall not exceed two-thirds of the value of the real estate or leasehold". This proportion was applicable to the whole period during which this report is preoccupied with the affairs of British Mortgage & Trust Company and was not changed till 1965 when it became three-quarters.³ The gist of section 142(1)(a), as will be recalled, was that a company might not invest in any one security an amount exceeding 15% of its capital stock and reserves, and similarly in the case of investment in any one company or bank maturing in more than one year; if the loan or investment matured in one year or less it might not exceed 20% of the same calculation plus 5% of its deposits and guaranteed investment funds. In 1966 the Act was extensively amended, and in particular section 142, to reduce the proportion of deposits and guaranteed investment funds from 5% to 2½%.⁴ Calculations of the actual amounts of these limitations as they affected British Mortgage & Trust Company for the period 1956-1964 have already been referred to and are found in Table 71.

The first page of Table 74 is a summary of the succeeding pages and contains adjustments necessary to reconcile the amounts of mortgages as listed in the annual statements to the Registrar of Loan and Trust Corporations over the years illustrated, together with the properties held for resale which had become so classified because of foreclosure proceedings, with the corresponding amounts shown in the company's published financial statements. The adjustments consisted of adding accrued interest at October 31, 1964 and July 19, 1965 and interest capitalized on properties held for sale. The mortgage portfolio was divided into a number of categories the first of which will be seen to be headed "Specific Mortgages". These consist of twelve groups in which all the individual mortgages were over \$50,000 and two of which, the mortgages to Tip Top Tailors Limited and to the Belfield companies, have already been noticed in this chapter, and those in connection with the Treasure Island Shopping Centre in London in Chapter VII. The balance of the loans of over \$50,000 have been divided into categories of security of sub-divisions, bowling alleys, leaseholds and mortgages, the last two referring to mortgages of leaseholds and mortgages of mortgages. The category "Other Mortgages over \$50,000" includes those where apartment and office buildings were the subject of financing and the security for the loans. Mortgages for amounts under \$50,000, which did not require listing in the annual statements to the Registrar,

³13-14 Elizabeth II, c. 61, s. 5.

⁴14-15 Elizabeth II, c. 81, s. 13.

are shown as amounting to 46.21% of the portfolio at July 19, 1965 as compared to 67.68% at October 31, 1960.

From 1959 onwards British Mortgage & Trust made loans on vacant land which was in the process of being sub-divided for building development. This was a distinct departure for a conservative lending institution and represented participation in a major development in the building trade, which, by 1965, only amounted to some 2.22% of the total portfolio. The loans were usually made for periods of two years, representing "interim financing" between the period of acquisition of the lands by the developer and the time when he was in a position to sell houses financed by long-term mortgages, and to secure partial discharges of the trust company's mortgage in relation to them. It should be noted, however, that, although the total amounts advanced under this category in 1965 consisted of only \$1,950,000 in round figures, two components of the specific mortgages category contained subdivisions as an element of their security. For instance, among the loans made to Hudson R. Elmore's ventures, amounting at October 31, 1964 to \$2,193,015, two were against sub-divided lands and the loan to Indiancrest, by then repaid, was of the same character. Similarly, to the category of shopping centres, shown as amounting in 1965 to \$5,337,000, or 6.09% of the portfolio, must be added the specific mortgages involved in the Treasure Island complex, Towers Stores, and Sentry Stores. As a result total mortgage loans made in respect of shopping centres would approximate by 1965 to \$13,240,000, or 15% of the portfolio. Mortgage loans made on the security of premises devoted to bowling alleys were, during the period under review, notoriously difficult to come by, and the entry of British Mortgage & Trust into this field, albeit to a modest extent, was indicative of the new direction imported to lending policy by the management of Wilfrid Gregory. As already remarked, the most notable change in the nature of the mortgage portfolio during the period was the increase in mortgages in excess of \$50,000, compared with those under that amount, from 32.32% at the year-end in 1960 to 53.79% as at July 19, 1965. Thus British Mortgage & Trust at the end of the period exhibited in its mortgage lending a growing tendency to make larger loans to fewer borrowers, and it was common knowledge among land developers and mortgage brokers that this company, formerly a model of conservative lending practice, was willing to take unusual risks at high rates of interest, buttressed by substantial bonuses.

Accounting Treatment of Reserve for Mortgages and Real Estate Held for Sale

Another feature of the first page of Table 74 requires explanation and comment. In the section entitled "Adjustment to Reconcile with Balance Sheet Amounts" there is an entry referring to the reduction of

investment reserve. This was the term used in the annual statement to the Registrar but, in the connotation of what is now being considered, referred only to that portion of the company's reserves set aside for mortgages and real estate held for sale. In the published financial statements of British Mortgage & Trust prior to that of October 31, 1964 the amount of this reserve was not shown on the liabilities side of the balance sheet, but was deducted from the amount shown as an asset under the head of "mortgages", and the figure on the assets side was a net amount described as "Mortgages—less reserve". Thus it constituted a hidden reserve, and the practice of not showing the actual amount deducted from the assets was by no means uncommon in the industry in the years under review. It has already been seen that Wilfrid Gregory had already won his battle with the Registrar's examiners on the subject of adding special or allocated reserves to the aggregate of his general or free reserves, in order to calculate the total of the company's capital and reserves in computing the ratios prescribed by section 142 of the Loan and Trust Corporations Act. Consequently for 1964 the reserve or allowance for loss allocated to the mortgage portfolio in the amount of \$900,900 was for the first time disclosed, not simply as a revealed reduction of the mortgage assets which would have been preferable under the circumstances, but as a liability which, incidentally, had the effect on the untrained eye of increasing the amount of the assets in that climactic year. There was, however, a hidden reserve of \$200,000 deducted from the amount at which real estate held for sale was carried in 1964, and this amount appears as the only deduction made under the date October 31, 1964 on Table 74. Accordingly, the deductions of investment reserve shown for 1960, 1961, 1962 and 1963 represent the total amount of the hidden reserves in respect of mortgages and real estate held for sale. Since in 1964 the mortgage reserve was disclosed, it has only been necessary in respect of that year to deduct the still hidden reserve against the latter. The figure for July 19, 1965, on the other hand, represents a reversion to the former practice by Peat, Marwick, Mitchell & Co. who considered it necessary to reserve \$1,430,000 in respect of mortgages and real estate held for sale, as compared with \$1,100,000 reserved by the company at October 31, 1964.

The Belfield Mortgages: Roy G. Calladine, L. W. Facey and W. A. Pike

None of the loans examined maturing in less than one year seems to have been in breach of the limitation that they should be less than 20% of the trust company's capital and reserves, plus 5% of its deposits and guaranteed investment funds. Looking at the specific mortgages on Table 74, it would, however, appear that the limitation on loans to any

one company maturing in more than one year of 15% of capital and reserves might have been breached; for example this limitation at October 31, 1961 was calculated at \$702,889 and as at that date there is listed as mortgage loans to Elmore an amount of \$1,104,250. Similarly in 1964, when the limitation was calculated to be \$1,134,021, there were apparent breaches in the cases of Elmore, the Belfield companies, the Towers stores, the Sentry stores and Treasure Island. In fact, the limitation was lawfully evaded in some cases by making separate loans, well within the limitation, to distinct although affiliated and related companies. The prime example of how these provisions limiting lending were evaded in the mortgage field was provided by the Belfield companies. The detail of amounts outstanding on mortgage loans to the Belfield companies is set out on Table 74 and they will be seen to involve twelve mortgages made to nine separate companies, the highest of which was \$893,000 made to 60 Belfield Road Limited, and amounting at July 19, 1965 to the very large sum of \$4,922,176 which made these closely related companies, taken together, the largest borrower by way of mortgage from British Mortgage & Trust Company.

Belfield Road is a thoroughfare situated in the Rexdale area of the Township (now Borough) of Etobicoke at the westerly limits of the municipality of Metropolitan Toronto. It lies close to and to the north of the Macdonald-Cartier Freeway, in a district designated for industrial development, and had attracted the attention of Roy G. Calladine who entered into an agreement for the purchase of 4.71 acres from one Robert Clarke Wardlaw for \$85,000, paying as a deposit thereon \$780, and began to clear the site for erection of a factory building in October, 1961, although the date of closing was November 30. He was at this time thirty-four years old and from 1945 to 1953 had worked as a tool-maker. In the latter year he had gone into partnership with two of his brothers to carry on building construction, from the start had the usual difficulty in obtaining operating capital and early became a judgment debtor. In 1957 he organized and caused to be incorporated Calladine Bros. Builders Limited which embarked on the speculative construction of factory and commercial buildings in Toronto and by 1961 had fixed upon the Belfield Road area as potentially profitable. By that time he had, under the guidance of his solicitor, the late Meyer Rotstein Q.C., learned to employ the device of incorporation to limit his own personal liability in his various enterprises, and Rotstein had through his own family company, Meyers Investments Limited, financed his operations in a small way, being repaid from advances made on mortgages given to British Mortgage & Trust.¹

The introduction of Calladine to British Mortgage & Trust was made by the latter's Toronto mortgage manager, Laurence W. Facey,

¹Exhibits 4718, 4814 and 5102.

whose name has been mentioned before. Facey was born in England in 1922 and came to Canada at the age of fifteen as an immigrant trained to do farm work, according to his own account, after being raised in a boys' home from early childhood. After service in the Royal Canadian Air Force during the war Facey was briefly a self-employed barber, then became a real estate salesman and in turn, upon passing the prescribed examination, a real estate broker. From 1950 to 1955 he was employed by the Northern Life Assurance Company of London, Ontario, as its Toronto mortgage inspector and in the autumn of the latter year he answered an advertisement in a Toronto newspaper inserted by British Mortgage & Trust. On November 1 he was hired by the then president, Mr. W. H. Gregory, to do similar work for that company under his own supervision. Facey took over the work of H. W. Patterson, its previous mortgage representative in the Toronto area, and was regarded as a successful and energetic employee. After W. H. Gregory's appointment as chairman of the board Facey reported directly to W. A. Pike, the mortgage manager in Stratford, and by the autumn of 1964 he supervised the work of three subordinate inspectors and a secretarial staff.²

William Arthur Pike, whose conduct as mortgage manager of British Mortgage & Trust Company has already been remarked upon in Chapter VII, was born in 1930 in Belfast, Northern Ireland, and was brought to this country as an infant in arms. He grew up in Stratford and at the age of eighteen became a clerk in the savings department of British Mortgage & Trust Company. He early fell under the favourable notice of W. H. Gregory, whom he used to accompany on mortgage inspection trips, and on June 7, 1954 he was appointed assistant secretary of the company by the board of directors.³ From 1955 onward he almost invariably acted as secretary of the meetings of both the board of directors and the executive committee. On January 20, 1959 he was appointed manager of the mortgage department of British Mortgage & Trust, a position which he held under it and its successor, Victoria and Grey Trust, until he was dismissed by the latter following his testimony to the Commission on April 4, 1966 to having taken \$10,000 in bribes in 1962 from Donald W. Reid on behalf of William and David King of London. By 1962 he was only thirty-two years old and had acquired a useful knowledge of the practice and principles of mortgage lending under the guidance and direction of the Gregorys whose confidence he enjoyed. During the course of his employment Pike was active in the affairs of the Canadian Junior Chamber of Commerce and became an Alderman of Stratford.

²Exhibit 5118.

³Exhibit 109.

Before reverting to the subject of the Belfield loans it must be remarked that in 1962 Calladine's methods as a builder and his performance as a borrower had been known to British Mortgage & Trust Company since 1960 when in July two mortgage loans, one for \$48,000 to Calladine Bros. Builders and one to Varsity Construction Limited, another of his companies, for \$58,000 were made by it to finance the erection of two small, adjacent factory buildings in the Township of North York. The solicitors who acted for the trust company in completing the mortgage transactions were Messrs. Shuyler & Ecclestone of Toronto. This firm was to act for British Mortgage & Trust in all the mortgage loans made to Calladine's Belfield companies and had a long-standing connection with the trust company since the days of Facey's predecessor, H. W. Patterson who was A. A. Shuyler's brother-in-law. A third mortgage loan of \$60,000 was made to Calladine's Miranda Construction Limited on November 30, 1960 and the greater part of the proceeds were used to pay off loans made by Meyer Rotstein and members of his family. Then two more loans of \$48,000 and \$58,000 were made to another Calladine company, Carnforth Leaseholds Limited, to permit construction of two small factory buildings on Carnforth Road in North York. Out of the first advance of \$49,000 on both loans over \$21,000 was required to discharge an existing mortgage to the vendor of the property to Calladine on which foreclosure proceedings had already been commenced. The final advance on the first building was not made until July 7, 1961 because of the failure to assign an acceptable lease to British Mortgage & Trust. When a second advance had been made in March, 1961 on the other building, Pike discovered from a belated report from Facey that the building was not only still unrented but had been mortgaged a second and third time to secure additional loans of \$30,000. These mortgages in due course gave rise to foreclosure proceedings and, as a consequence of this uncertainty and financial irresponsibility on the part of Calladine, British Mortgage & Trust never completed its advances.

Two more comparatively small loans in this early period of the mortgage transactions with Calladine must also be noticed. On June 13, 1961 \$15,000 was advanced to a partnership consisting of Roy G. Calladine, Noel E. Calladine and Joseph Lanzino, secured by a mortgage on a small commercial building at 350 Blackthorne Avenue in York Township and collaterally secured by assignment of the lease of the premises given by the mortgagors to Lanzino himself and one Frank Fazio. The property was sold in the course of nine days and the loan subsequently repaid. In the same month Miranda Construction successfully applied to British Mortgage & Trust for a loan of \$50,000 to be secured by the mortgage of a factory building in the course of construction on Shaft Road in the Township of Etobicoke. Facey reported to Pike that the building was leased to Cordoni Foods Limited, a company

engaged in the manufacture of Italian foodstuffs owned by one Cordoni, Joseph Lanzino, and the Calladine brothers. Having obtained the executed mortgage and the assignment of the lease, Ecclestone disbursed the first advance of \$30,000, but on August 17 he was compelled to return a cheque for the second advance of \$10,000 to British Mortgage & Trust because of the registration of two mechanics' liens against the property. In September Rotstein advised the trust company that Cordoni Foods had failed because of a disastrous fire and it was permitted to cancel its lease to Miranda Construction. The lien problem was not resolved till the property was bought by Samuel Schacter who entered into a lease with his own company, Acro Gasket Industries Limited, also in due course assigned to British Mortgage & Trust, and the loan was fully disbursed. This transaction was complicated by an attempt to substitute other premises for those on Shaft Road because of Pike's initial refusal to accept an assignment of the Acro Gasket lease which he considered not to be at arm's length. Details of the subsequent history of this mortgage loan, which was in arrears by 1963, are not important, but mention must be made of a letter written on October 27, 1961 by Pike to Ecclestone on the occasion of the latter returning the British Mortgage & Trust cheque for another advance:⁴

"As this is the third time you have had to return a cheque due to liens which the owners cannot discharge, you are no doubt becoming as impatient as ourselves with Calladine Bros."

The foregoing brief reference to these mortgage loans to Calladine companies is based on information taken from files of British Mortgage & Trust and Shuyler and Ecclestone and to some extent from the examination of Pike under the Securities Act conducted by Mr. Cartwright on July 12, 1967⁵ and again on February 19, 1968. It should be said, by the way, that the evidence given to the Commission by Mr. Walker on the subject of the Belfield loans⁶ revealed a situation which required intensive investigation by the Commission, only completed in 1968, over a year after its hearings were concluded. This investigation led to an even more extensive inquiry into the affairs of Roy G. Calladine by the Attorney General's Department in Ontario and the Department of Justice, resulting in his arrest and the preferment of charges against him. Some use, therefore, has been made of material collected by the Commission, but not produced or referred to at its hearings, in order to reach conclusions on as much as possible of the relevant evidence which has so far come to light on the relationships between Calladine, Facey, Pike and Wilfrid P. Gregory. For the moment, it is sufficient to say that both Facey and Pike were aware and

⁴Exhibit 4935.

⁵Exhibit 4901.

⁶Evidence Volume 110.

Gregory, to whom every mortgage loan of more than \$15,000 was submitted by Pike, should have been aware that Calladine and his companies were unreliable borrowers some time before the first large loan was made to Belfield Investments. The early transactions also illustrate the procedure, which British Mortgage & Trust followed, requiring the borrower to lease space in a building under construction or upon completion, and to assign to it the leases entered into before final advances were made in order to protect it against default in payment of interest and principal. The amount of annual rental payment was not, as far as can be discerned, the subject of any fixed ratio to the amounts advanced to borrowers in the course of disbursing mortgage loans, although they might appear to have been fixed by Pike's instructions to Shuyler & Ecclestone at not less than one-quarter of the total advances.

The First Mortgage Loan to Belfield Investments: 70 Belfield Road

The application for a mortgage loan of \$320,000 for fifteen years, bearing interest at 8% per annum, providing for monthly payments in the amount of \$4,285 and required for the purpose of "assisting with costs of construction" for the new building situated on the 4.71 acres referred to above, was made by "Belfield Investments Limited" on September 20, 1961, and its approval by the executive committee was attested to by the initials of W. H. and W. P. Gregory, H. W. Baker, H. B. Kenner and A. B. Manson on October 17, 1961, or nine days before the company known as Belfield Investments Limited was in fact incorporated. The application was forwarded by L. W. Facey accompanied by his own valuation of the land and proposed building in the amount of \$610,000. Special conditions attached to the application called for four advances of \$80,000 each to be accompanied by assignment of leases producing annual income of \$20,000 for the first advance, \$40,000 for the second, \$60,000 for the third and \$75,000 for the fourth.¹ A new feature of the arrangement between the company and Calladine who signed the application, and one that was to be common to all the subsequent large loans, was an agreement that British Mortgage & Trust should act as rental agent and manager of the property at a fee amounting to 4% of the gross annual rentals, although the formal agreement to this effect was not concluded until February 2, 1962. As it turned out this documentation was not as dilatory as would first appear because almost at once difficulties developed about the provision and assignment of leases. Ecclestone is to be found reporting to the trust company on January 17, 1962, that, although the mortgage had been registered, he was not yet in a position to certify the title and had received no leases from Calladine who appeared at this point to

¹Exhibit 4528.1.

have been doing his own renting. On January 26 Ecclestone forwarded the executed leases to Stratford, the first being from Joseph Lanzino, Frank Fazio and Giuseppe Quattrochi to yield an annual rental of \$21,000, the second from Marvin Rosen to yield \$12,600 and the third from Apco Consultants Limited to yield \$12,600, all for a term of ten years. Then, on January 30, Facey certified to Pike that a first advance of \$160,000 was warranted and the following day Pike sent the company's cheque in that amount to Shuyler & Ecclestone for disbursement. Out of this amount approximately \$130,000 was payable at once to existing creditors of Belfield Investments, though not all of them, including upwards of \$80,000 to discharge the principal and interest owing on the vendor's first mortgage.

The three leases referred to require examination. Lanzino, one of the three lessees under the first, was a close associate of Roy Calladine and had acted as his construction foreman according to the payroll of Belfield Investments.² Frank Fazio, eventually located in Vancouver, gave a voluntary statement under oath to Detective W. A. Smythe of the Commission's investigating staff on October 25, 1967, in the course of which he denied having signed the lease, asserting that the signature "Frank Fazio" was not only not in his handwriting but that he signed all documents with his proper Christian name of "Francesco". He stated that he did not know the third lessee, Quattrochi, and had never contemplated or commenced business operations with either him or Lanzino. None the less he had taken the precaution of calling Lanzino the evening before his interview with the police officers and gave the following chilling account of what had transpired:³

"... And they told me there was only one G. or J. Lanzino listed in the phone book, and I wasn't too sure if it was him or somebody else. And I called the person to person call Joe Lanzino, and he answered on the phone. I said, 'Joe, I am Frank.' He said just a minute, I go to the basement to get the phone. He didn't want his wife to hear. And I had to wait about a minute, and he went downstairs and talked to me. So Joe, I says, there is a man looking for me here with the police regard the leases. I say I don't know anything about it. He said well, what did you tell him? I told him I didn't sign it. And he say you should tell him, or said otherwise you put Calladine in troubles. I said, 'Joe, I don't care, I don't sign it, and I going to tell them the truth. I don't know nothing about it.' And I asked him a couple of questions about it, but I didn't have any answer to suggest—he tried twisting things around you know. Say would be better for me if I would tell them I would sign, would be no damage on me, would be no expense, that's all. I also like to—that call I make, I didn't make it for personal matter. I make it just to clear up myself, and I would like to somebody else look after the call. I talked

²Exhibit 4894.

³Exhibit 5121.

to him for about nine minutes, ten or eleven, and I would be very glad if somebody look after the call.

Q. Did he say that anything would happen to you if you did say you hadn't signed?

A. He didn't say directly, but I tell you the truth. The last days I don't like very much. He didn't say nothing directly to me, but the way he was talking I didn't like it. Don't get me wrong, but I didn't like the way he was talking, because Joe was a friend."

The second lease given by Belfield Investments on the same day, January 24, to Marvin Rosen⁴ was to accommodate a clothing business. Three or four weeks later Rosen, who was unable to identify the witness's signature on the lease itself, said that he had informed Calladine that his business had not materialized and that Calladine had been most annoyed. Annoyed or not, he caused Belfield Investments to pay Rosen by cheque the amount of \$150 on March 22.⁵ The third lease given to Apco Consultants Limited was expressed to run from February 1, 1962 for ten years. This company's president was George S. Scott who executed the lease in that capacity, and in the course of his examination⁶ said that his company had done work clearing sites for Calladine as a sub-contractor. He had considerable difficulty getting paid for the work done until approached by Calladine with a request to sign the lease and an explanation that this would procure funds for payment of the Apco account. Scott had no intention of occupying space in the Belfield building, first, because the doors were too small to accommodate his equipment and second, because he did not believe that the zoning regulations of the Township of Etobicoke would permit its accommodation. In fairness to Calladine it should be said that he was anxious to lease the whole building to a substantial tenant or sell it, and evidently regarded the assignment of the leases to British Mortgage & Trust as an irritating formality with which it was necessary to comply in order to get an advance of mortgage funds. Nevertheless his lack of scruple about concocting them was a bad omen for the future and, if known to the trust company's officers, should have given them reason to pause at this early stage of the financing of the Calladine enterprises. No rent was ever paid under these leases to British Mortgage & Trust and on the Lanzino, Fazio and Quattrochi folio there is a note: "Cannot find out who these people are."

The second advance of \$80,000 was made on March 6, 1962 against the assignment of leases by Belfield Investments, reported as being to Armstrong Door Company for ten years at an annual rental of \$1,260, Moulton Machine Company for five years for \$4,800 and Fletcher Imports for five years for \$5,500. The Armstrong Door lease⁷

⁴Exhibit 4772.

⁵Exhibits 4894 and 4899.

⁶Exhibit 4898.

⁷Exhibit 4772.

was signed "T. Armstrong". Norman A. Armstrong the proprietor of Armstrong Door Company was examined⁸ and testified that the signature was neither that of himself nor of his son, T. Armstrong. Armstrong made overhead doors for Calladine buildings and was owed substantial sums by Calladine Bros. Builders, Miranda Construction and other Calladine companies. He occupied space in the building under a verbal agreement with Calladine that for five years Belfield Investments would acknowledge payment of rent at \$100 per month to reduce its accounts payable to Armstrong. This arrangement was never reduced to writing in spite of numerous requests by Armstrong, nor was a lease ever furnished to him. The second lease was executed by "M. Moulton trading as Moulton Machine Co. and the said Moulton Machine Co." and apparently signed by "Morris Moulton". The signature of the witness was considered illegible by Ecclestone but appears on examination to be "A. Greenspoon".⁹ The Commission's investigators were unable to trace "Morris Moulton" but subsequently, in May of 1962, at the time of the third advance, a genuine lease was entered into with J. L. Moulton carrying on business as Systematic Tool and Die Shop for the more modest rental of \$2,400. The lease to Fletcher Imports was executed by "Charles Fletcher" witnessed by one Viola Parker, secretary to Meyer Rotstein, now too infirm to be of any assistance to the Commission. "Charles Fletcher", like "Morris Moulton", has never been traced or identified, and no rent was ever received by British Mortgage & Trust acting as rental agent from these three leases. All attempts by Shuyler & Ecclestone to obtain acknowledgements by registered mail of the tenancies in these six instances were abortive and were so reported to Pike.

By the date of the second advance British Mortgage & Trust's Toronto mortgage manager L. W. Facey had become a director of Belfield Investments. From March 1, 1962 onward he held this position with one of the \$1 shares issued and subsequently, when 600 shares were issued at \$1 per share, he held 200 together with Roy G. Calladine and Richard Watson. Illuminating notes in the handwriting of Meyer Rotstein, identified by his son Maxwell,¹⁰ appear on the former's file on the incorporation of Belfield Investments Limited¹¹ and on the back of a blank legal form found in it. The first reads:

"Nov 7/61 Gave Charter to Roy
Miss Parker signed share certif in
blank (to Pike & Br.
NB (already British Mtg)
(first mge money)) NB"

⁸Exhibit 4902.

⁹Exhibit 4772.

¹⁰Exhibit 5102.

¹¹Exhibit 4718.

and the second:

“Director—Facey
Her qualifying share
Is ~~held~~ was transferred
to Facey & Pike”

The fact that Facey was a shareholder of Belfield Investments and subsequently, when the company was organized, a director and vice-president, was known to Ecclestone who acted for British Mortgage & Trust in all the Calladine-Belfield loans and for Facey himself, according to his own account, at some time in 1962. He maintained that he did not know about the involvement of Pike till 1964, shortly before Belfield Investments became bankrupt in September. Both Pike and Facey admitted that they participated equally in this and in Belfield companies incorporated subsequently. Later it will be necessary to consider to what extent this arrangement was known to Wilfrid Gregory and to the directors of British Mortgage & Trust Company, and, although something can be said for Facey in extenuation, the position of Pike was totally without justification or excuse. The possibility of British Mortgage & Trust remaining at arm's length with Roy Calladine in transactions which were to absorb over \$5,000,000 of its investment funds, with its mortgage manager and his principal subordinate collaborating in his construction schemes, was remote indeed.

A third advance to Belfield Investments for its enterprise at 70 Belfield Road was authorized by Pike on April 26, 1962 and disbursed by Ecclestone on May 3 and the final advance of \$10,000 was made on July 11. By this time the following leases had been entered into and assigned to the trust company as collateral security, all but one of which, to North West Transportation Association Limited, resulted in payment of rent although, as will be seen by comparing the terms and the record of payment, not for long.

<u>Lessee</u>	<u>Terms</u>	<u>Annual Rent</u>	<u>Rents Paid Per B.M.T. Ledger</u>
Power Wash Equipment	5 yrs. April 1/62	\$ 3,800.00	Rent Paid May/62 to Sept. 64
J. S. Staedler Canada Ltd.	5 yrs. March 23/62	2,400.00	Rent Paid June/62 to Oct/62
R. G. Adler	5 yrs. April 9/62	2,196.00	Rent Paid June/62 to Oct/62
North West Transportation Association Limited	10 yrs. May 15/62	4,368.00	No Rent Paid

<u>Lessee</u>	<u>Terms</u>	<u>Annual Rent</u>	<u>Rents Paid Per B.M.T. Ledger</u>
Summerhayes Steel & Service Centre Limited	5 yrs. May 1/62	4,803.00	Rent Paid June/62 to December/62
Synthetic Maple Syrup Co.	5 yrs. May 1/62	2,200.00	Rent Paid June/62 to October/62 then bankruptcy
Cardinal Lamps Limited	5 yrs. June 1/62	8,550.00	Rent Paid June/62 to September/64
Alec Cypha	5 yrs. May 1/62	2,400.00	Rent Paid May/62 to September/62
J. L. Moulton— Systematic Tool & Die Shop	5 yrs. May 1/62	2,400.00	Rent Paid May 1/62 to September/64
		<u>\$33,117.00</u>	

50 Belfield Road Limited and 60 Belfield Road Limited

The next Calladine venture to be noted required the incorporation of two companies, both on June 4, 1962, known as 50 Belfield Road Limited and 60 Belfield Road Limited. Both these companies, which have already been referred to in connection with the participation of Aurora Leasing Corporation at a later stage of their financing, had share capital of \$600 equally divided between Calladine, Facey and Watson who were the directors, and held title to adjoining properties on the north side of Belfield Road on which Calladine originally planned to erect one industrial building. An application was made by Belfield Investments in respect of this building for \$600,000 at an interest rate of 8% per annum for twenty years and was forwarded by Facey to Stratford on April 18, accompanied by a letter in which he acknowledged that he was a director of Belfield Investments.¹ The project was on a much larger scale than the building constructed at 70 Belfield Road by Belfield Investments and adjoined it immediately to the east. The plan was shortly after expanded with a view to enclosing some seven acres under one roof for which additional financing was required. There then ensued a development which was to be repeated on two subsequent occasions, resulting in the incorporation of 60 Belfield Road Limited to hold the first section of the building and 50 Belfield Road Limited the second. The building was constructed in the shape of an "H", with a connecting corridor near its Belfield Road frontage, and the increased loan was divided finally between the companies in the proportion of \$900,000 to 60 Belfield Road, which had all been advanced by February, 1964, and \$550,000 for 50 Belfield Road on which \$543,000 was

¹Exhibit 4760.

advanced. According to Pike this device was suggested to him by Wilfrid Gregory to overcome the limitations imposed by section 142 of the Loan and Trust Corporations Act in connection with loans to any one company maturing in more than one year.² The limitation of 15% of the sum of capital stock and reserve in the case of British Mortgage & Trust amounted at October 31, 1961 to approximately \$703,000 and at the following year-end to \$823,000. This assertion was not put to Gregory, since it was made nearly a year after his appearance before the Commission. It is not unlikely that Pike discussed the loaning limitation with Gregory on many occasions and on a matter of this moment he may very well have asked for advice. In any event Pike was conscious of difficulty on June 21, 1962 when he wrote to Shuyler & Ecclestone enclosing a first advance of \$374,250, saying that British Mortgage & Trust was pleased to do so "even though the circumstances are completely different than those upon which the loan was approved" and adding "with the mortgage on 70 Belfield and this \$600,000 we are exceeding (on paper) the amount which we may legally advance to one company. We are therefore going to insist that not more than \$500,000 be advanced under the 50 and 60 Belfield mortgage until some definite arrangement is made with regard to the sub-division of land."³

Although the leases of space in the new complex were shorter in term than expected by British Mortgage & Trust, they did not involve the straw men who had bedevilled the situation at 70 Belfield Road, and included one to Dominion Stores Limited, undoubtedly a "triple A" tenant, to use the untranslatable jargon of the trade. At the end of 1962, after a further \$200,000 had been successfully applied for by Calladine for 50 and 60 Belfield Road, secured by second mortgages to British Mortgage & Trust, these were unexpectedly paid off through a second mortgage given to Coronation Investment Company Limited. British Mortgage & Trust was not called upon for any more financing until January, 1964, when it increased its first mortgage commitment by \$250,000 advanced to 60 Belfield Road, bringing the loan to that company to its final extent of \$900,000. In the midst of these massive investments a minor transaction must not be overlooked. Meyers Investments Limited had taken a third mortgage on the property of 50 Belfield Road Limited behind one of \$150,000 held by C. F. O'Neill, president of Premier Finance Corporation, with a face value of \$10,000 to secure the fees and disbursements of Meyer Rotstein. After the last advance of \$50,000 on the British Mortgage & Trust loan of \$550,000 to that company Ecclestone reported to the trust company on November 16, 1962 on the steps he had taken.⁴

²Exhibit 5104.

³Exhibit 4787.

⁴Exhibit 4533.

"We made a subsearch of the title and found the same to be in order with the exception that P. Susin Construction Company has filed a mechanics lien in the amount of \$34,705.75 on each of the properties, that is, numbers 50 and 60. We had some doubt from your instructions as to whether you understood that there was a lien for that amount filed on each of the properties, but spoke to Mr. W. P. Gregory who authorized the advance to be made notwithstanding the registration of the two liens. The advance was completed on the 15th instant.

As you know, the property is subject to a second mortgage in the amount of \$100,000.00 held by Mr. C. F. O'Neill which also covers numbers 60 and 70 and a third mortgage held by Meyers Investments Limited with a principal amount of \$10,000.00 of which we were instructed the amount of \$7,286.50 only had been advanced.

We received the usual form of Release and Waiver from both the second and third mortgagees although, in fact, the third mortgage was to be paid off out of the proceeds of the advance. As the advances made on the third mortgage to the extent \$7,286.50 are probably prior to the mechanics' lien of P. Susin we considered it advisable to take an assignment of this mortgage and this was taken in the name of Mrs. Margaret Facey. We have not, however, registered the Assignment of Mortgage. We have arranged through the solicitor for Meyers Investments Limited, who is also the solicitor for Belfield Investments, that if the Assignment to Mrs. Facey is not satisfactory he will prepare an Assignment to any other person or a discharge, if the Company so requests.

We understand that an application is being made on the 23rd instant for an Order of the Court under The Mechanics' Lien Act determining the amount required to be paid in to discharge the Susin lien. We will keep you advised as to the results of this action as it progresses."

The mortgage to Meyers Investments had been prudently registered on October 30, three days before that of the Susin mechanics' lien. The sum of \$7,286.50 was accordingly paid to Rotstein and included a payment of \$1,500 to the Canadian National Railways on account of the costs of a railway siding and \$200 for incorporation fees for two new Calladine companies, Indus Investments Limited and Surpass Investments Limited; after a great deal of complicated conveyancing, the details of which need not be recorded, the Susin lien was discharged and Mrs. L. W. Facey held a third mortgage on 50 and 60 Belfield Road. Since the ostensible reason for assigning rather than discharging the mortgage was to preserve an advantage over a lienholder whose claim was considered by the court to be highly inflated, a payment of \$7,329.80⁵ to Margaret Facey on February 7, 1963 out of the proceeds of the Coronation Investment second mortgage was a strange development, and stranger still was payment by her four days later to Lucy Pike, wife of W. A. Pike, of the amount of \$3,614.90.⁶ Ecclestone agreed

⁵Exhibit 4717.

⁶Exhibit 4837.

that on this occasion he acted for Mrs. Facey, only to a limited extent, in drawing a discharge of a mortgage and picking up the cheque.⁷ When pressed by Mr. Cartwright as to whether he thought there was any impropriety in the payment to her he said that he had discussed the matter with Shuyler, had no reason to be suspicious of her husband and that "we just took the position that it was not any of our business". Messrs. Blake, Cassels & Graydon, acting as solicitors for Coronation Investment had, in his view, undoubtedly disbursed the money on the direction of Belfield Investments and there the matter ended as far as he was concerned until long afterwards when, on the eve of the Faceys' move to the west, Margaret Facey had called him on the telephone:

"She sounded hysterical; I believe she was crying. She said to me, did I have that cheque that she got out of the mortgage? I said I did. She said: 'Roy told me to keep it and I gave half of it to Lucy Pike'."

Calladine, in his examination for discovery in the bankruptcy of Belfield Investments,⁸ said that he did not recall the details of the transaction "at this moment". Facey, in his voluntary examination under oath in Vancouver, said, "my recollection isn't very good about this mortgage". Pike however readily admitted that he knew in November 1962, when the Meyers Investments mortgage was assigned to Mrs. Facey, that he would eventually share equally with her husband in the proceeds when the mortgage was discharged, in effect for the second time.

Indus Investments Limited and Surpass Investments Limited

By July 1962 the Belfield Investments building at 70 Belfield Road was substantially complete and those of 60 and 50 Belfield Road were under way. Roy Calladine was not one to rest on his oars and launched his third development on a parcel of some 32 acres in an industrial park near the intersection of Belfield Road and King's Highway No. 27. The same procedure was followed as for 60 and 50 Belfield Road in that two buildings were to be constructed, joined together by a membrane corridor, and two distinct companies formed to hold the divided land and give mortgages to British Mortgage & Trust Company. These companies were Indus Investments Limited and Surpass Investments Limited; the land was purchased from a private company called Indian Line Investments Limited for \$285,000 in a transaction which required a \$5,000 deposit, a payment of \$55,000 on closing and a first mortgage given back to the vendor to secure the balance of \$225,000, bearing interest at 7% per annum. Indian Line agreed to postpone its mortgage to one given to British Mortgage & Trust and the agreement for sale was assigned by the purchaser Cecil R. Early, Calladine's father-in-law, to

⁷Exhibit 5103.

⁸Exhibit 4350.

Indus Investments Limited which was incorporated on October 22, 1962. The consideration for this assignment was, according to Calladine, \$40,000 in notes, and Early was in fact paid \$39,000 by Belfield Investments on May 21, 1963, the \$5,000 deposit having previously been repaid to him out of advances from British Mortgage & Trust. Thereafter the total consideration for this parcel of land, half of which was considered to be held by Indus Investments in trust for Surpass Investments, which was, in its turn, incorporated on November 1, 1962, was expressed as \$325,000 in the land transfer tax affidavit accompanying the grant of half the property to the latter company. Because of delay caused by the necessity of making an application to the Planning Board of the Township of Etobicoke for permission to subdivide the land conveyed to Indus Investments, British Mortgage & Trust agreed to make advances on one mortgage on the whole parcel, provided that it be replaced by separate mortgages from Indus Investments and Surpass Investments when this approval was obtained. Accordingly on December 6, 1962, Indus Investments applied to the trust company for a loan of \$532,000 for twenty years at 8% per annum¹ and the application was accompanied by L. W. Facey's usual "letter of submission" on behalf of the applicant of which he was, together with Calladine and Watson, an original incorporator. His valuation of the Indus portion of the property was \$882,000, based on the completion of construction, and \$836,000 for the land and projected building for which Surpass Investments made an application for a loan of \$508,000 on the same terms on December 7.

The first advance on the loan to Indus was made in the gross amount of \$165,000 with a request to Shuyler and Ecclestone to procure the assignment of enough leases to "substantiate this amount." The first two leases reported as having been concluded were to (Toronto) Atlas Warehousing Limited and to Charles Lanigan described as "trustee for a limited company with no personal liability". The first was to be void if the premises were not completed on or before July 1, 1963, a contingency which materialized, and the second which was said to be for a term of fifteen years at a rental of \$4,583.33 per month was even more ephemeral. When Ecclestone forwarded the assignment of this lease to British Mortgage & Trust he pointed out that he had not yet received an acknowledgment of tenancy, but the fact that he later sent a registered letter to Charles Lanigan, addressed to Brockport Road, Rexdale, Ontario, which was returned with the inscription "cannot locate", does not seem to have been reported in any subsequent correspondence with his client.² On his examination he stated that he had no recollection of the return of the registered letter and "guessed" that his firm had never reported it to British Mortgage & Trust.³ After making every allowance

¹Exhibit 4548.1.

²Exhibits 4792-4.

³Exhibit 5103.

for the stresses of a busy solicitor's work, this train of events in an important mortgage transaction must be considered a remarkable lapse of memory, particularly since no rent was ever paid under the lease and Charles Lanigan has remained only a name in spite of determined efforts by the Commission's investigators to establish his existence. The signature "C. B. Lanigan" appears on two documents, an offer to lease on a form of Feller & Kates Real Estate Limited and the lease itself from Indus Investments. The signature on the lease was witnessed by Mr. Feller who told the Commission's investigator that an unkempt individual, whom he did not usefully describe, appeared in his office, to execute the offer and withdrew with all copies of it, promising to forward a cheque for \$27,000 as prepayment of rent. Calladine, who was examined on several occasions prior to investigation of the Lanigan mystery and was no stranger to the Commission's offices, was invited by counsel to explain the matter and to bring Lanigan with him. Although this invitation was repeated in writing to Calladine's solicitors, neither he nor they produced any explanation, and it is clear that British Mortgage & Trust's advance of \$165,000 was made without collateral security of any kind. I am forced to the conclusion that Calladine on this occasion resorted to fraud to obtain the money he needed.

By the late winter of 1963 Pike in Stratford was openly expressing his concern about Calladine and the Belfield companies although not, one gathers, in the meetings of the board of directors and the executive committee of his company. On March 26 he wrote to Ecclestone:⁴

"It seems that we are about to enter another situation which seems to come up every time Mr. Calladine decides he needs more money. There is a great panic to attend to details and as often as not we are required to make exceptions to what we consider sound lending practices in order to bail him out. Some time this is going to have to stop and in this regard I am going to have a meeting with Mr. Facey within the next three days. Perhaps in his capacity as a Director he can speed things up."

But Pike and Facey were too deeply involved to bring Calladine into line and as for speeding things up the ball was at the latter's feet. A new figure in the leasing situation then appeared, an associate of Roy Calladine called Frederick Michael Bongelli, alias Frederick Michaels. On May 6, 1963 "Frederick Michaels & Associates (Hi-Way Warehousing)" offered to rent⁵ 60,000 square feet of the Indus Investments building for ten years from June 1, 1963 at an annual rental of \$60,000. Two days later a lease between Indus Investments and Frederick Michaels, carrying on business as Hi-Way Warehousing,⁶ was entered into, drawn by Spring & Greenbaum, the solicitors to which Meyer Rotstein's son Max-

⁴Exhibit 4796.

⁵Exhibit 4723.

⁶Exhibit 4794.

well had been articulated on the death of his father in April. When this document came into the hands of Ecclestone he disbursed a \$300,000 advance on May 17.⁷ Then on August 7 Ecclestone advised Pike⁸ that the lease from Indus Investments to Hi-Way Warehousing was to be surrendered and a new one on the same terms entered into for the same amount of space in the Surpass building, at the same annual rental to run from September 1, 1963. Assignment of this lease by Surpass to British Mortgage & Trust was dated August 14 and duly registered by Ecclestone five days later. The British Mortgage & Trust books for the property management account⁹ show that no rent was ever paid by Hi-Way Warehousing for the space leased in either building.

As in the case of Marvin Rosen, Frederick Michaels as F. Bongelli, two days after the execution of the first lease to Indus Investments, was the recipient of two cheques from Belfield Investments for \$50 each and two more for \$50 and \$200 on May 15 and May 22 respectively; weekly thereafter, from May 24, he received eleven payments of \$100 a week, all being debited to the wages account. Bongelli was examined under the Securities Act¹⁰ and the following exchange occurred:

“Q. How would you get money, for example, to put down a deposit on making an offer to rent space from one of the Belfield companies right at the beginning?

A. Well, I had some money.

Q. Did you receive any outside financing?

A. I don't have to answer that, do I?

Q. I put it this way. Did you receive any outside financing from Mr. Calladine?

A. Not at this stage of the game.

Q. At what stage did you?

A. When we went into a partnership.

Q. And how much financing did you get?

A. That I don't know. You would have to check with the bank. Actually nothing, only the fact that it was necessary for me to get somebody like Calladine to guarantee money at the bank. Actually I don't think—whether Calladine actually put out the money or arranged it through the bank I don't know.”

On September 26 a warehousing business was incorporated under the name of Two Seven Warehousing Limited, Roy Calladine taking 90% of the shares and Bongelli 10%; thereafter the new company did some warehousing business under the name of Hi-Way Warehousing and

⁷Exhibit 4814.

⁸Exhibit 4554.

⁹Exhibit 4903.

¹⁰Exhibit 4895.

under its own name, and appeared frequently as a tenant of buildings under construction by other Belfield companies at critical moments when advances were urgently required from British Mortgage & Trust Company.

Trans-Dallas Investments Limited

The third building in the Highway 27 and Belfield Road area was planned to occupy land in the rear of the Indus-Surpass buildings and was the subject of an application for a loan of \$800,000 made by Trans-Dallas Investments Limited, incorporated on June 26, 1963, and forwarded to Stratford by Facey on September 26; approval by British Mortgage & Trust was conveyed in Pike's instructions to Shuyler, Ecclestone & Green on October 1.¹ The first \$400,000 advance was made, without any leases having been negotiated or assigned, two days after the application was approved. Two substantial leases, one from Sherbrooke Paper Products Limited and the other from Fluid Power Limited, for a total of \$80,020 in annual rentals were then produced and justified a second advance of \$100,000 on January 10, 1964. Part of the Sherbrooke space, however, was not at first occupied and Hi-Way Warehousing was again called on to fill the breach, so that on January 15 another \$100,000 gross advance was considered justified. A final advance of \$150,000 was authorized on June 22, 1964, bringing total advances to \$750,000 with the production of three more leases, two being of modest and genuine proportions, from Miles Laboratories Limited for an annual rental of \$12,400 and Rotor Electric Company Limited for \$2,800 and the third from Two Seven Warehousing Limited in the apparently substantial amount of \$43,600 per annum. One of the weaknesses of the building management agreement between British Mortgage & Trust and Belfield Investments was its failure to provide for the payment of all rent to the former, and in the case of this building all that was ever paid went directly to Belfield, except for one month's rent in advance from Miles Laboratories Limited and rent from Sherbrooke Paper Products Limited until August 1964, after which the Belfield complex sank under the load of its accumulated liabilities into a state of bankruptcy. From the first advance to Trans-Dallas Investments \$50,000 was appropriated by Belfield Investments to provide the penalty demanded by Indian Line Investments, for the discharge of its second mortgage on the Indus-Surpass property which contained no privilege of prepayment. The part played by Aurora Leasing Corporation in re-financing the companies affiliated with Belfield Investments, to the extent of \$850,000 lent to it by British Mortgage & Trust Company, has already been described but, to complete that picture, reference should be made to Table 75² which sets out the distribution of these funds as

¹Exhibit 4798.

²Exhibit 4376.

between properties owned by 50 Belfield Road, 60 Belfield Road, Indus Investments, Surpass Investments and Trans-Dallas Investments, the valuations of Facey and his staff, the face value of the British Mortgage & Trust mortgages with the amounts advanced and the ratio of the total loans made to those valuations as at February 7, 1964 when the Aurora Leasing transaction was complete.

Parkay Investments Limited and Trans-Swiss Investments Limited

In the meantime Calladine had launched another enterprise on property described as 98-100 Rutherford Road in Brampton, Ontario, to take the familiar form of two conjoined buildings financed by first mortgages to British Mortgage & Trust from two separate companies, Parkay Investments Limited incorporated on July 9, 1963 and Trans-Swiss Investments Limited incorporated on November 26. In his letter of submission Facey represented, as he had before, that the shares of these two companies would be wholly owned by Belfield Investments, although by this time he was well aware that they were to be held by common directors, since he was one of them. The application was made by Belfield Investments in trust on November 12 and Pike wrote to Shuyler, Ecclestone & Green beginning as follows:¹

"Mr. Calladine has undertaken a new venture in Brampton and we have today approved two mortgages of \$600,000.00 each and shall be obliged if you will act for us.

I understand that a company to hold these properties has not yet been incorporated. The applications came to us from Belfield Investments Limited, in trust, but we will, of course, have to take the mortgages from a new company. We are unable to advance further funds to Belfield."

Perusal of the correspondence shows that, at least on paper, Pike was prepared to make a determined effort not to advance loans in respect of these buildings until the leasing requirements had been fulfilled, and there were other indications that Roy Calladine had worn out his welcome in Stratford. In his evidence before the Commission, Wilfrid Gregory had this to say on the subject.²

"A. . . . Then, they were getting ready to build a building in Brampton, which I didn't want to do. I wasn't enthusiastic about it. They said, 'Well, we have sort of committed ourselves with Mr. Calladine; we have to go ahead with this one' I said, 'It seems out of the way'. And they said they have been up to Highway 7 and up to Brampton and this is how things were, and we had an office in Brampton and this is the next step.

Exhibit 4802.
Evidence Volume 116, pp. 15837-8.

Q. When you say 'they' said something; do you refer to Mr. Facey?

A. No, I refer to Mr. Pike. I rarely discussed it with Mr. Facey but it would come from Facey to Pike to me. I said, 'If you have committed ourselves you have to go along with it, but this is the last and I want Mr. Calladine advised that this is the last loan we will be making him'. And that is the way it turned out. After that he borrowed some money from Canada Trust on his next building in east Toronto, at 8 per cent I believe, and they terminated the arrangement after one building. Then, they went to Coronation Credit and in the middle of the thing it disappeared and they went bankrupt. As far as Mr. Facey was concerned it was after the bankruptcy when I was down looking up the information about it and looking into it.

Q. You refer now to the bankruptcy of Belfield in 1964?

A. Right."

When Pike was examined on February 19, 1968 he confirmed Gregory's recollection.³

"Q. Now, Trans Swiss and Parkay, the two developments on Rutherford Road in Brampton. If I remember Mr. Gregory's evidence correctly, and I will be glad if you will accept what I say as an accurate résumé, I believe there was some comment in his evidence where he stated the financing for the Brampton project was to a slight extent not in his best judgment. He left an inference, and I hope I am being fair in this, the matter was brought to him by yourself and Mr. Facey to finance these two buildings. And he wasn't entirely in accordance with it, but he agreed. Can you assist me in that at all?

A. I think that is essentially right. I think that he asked some member of the Brampton branch about the feasibility of a building of this size in Brampton.

Q. What were your arguments in favour of this project?

A. I must say I didn't think in favour of it.

Q. Was there any pressing need to go ahead with it?

A. Not a bit that I know of.

Q. It involved two mortgages of \$600,000. I was wondering whether there was necessity to get that sort of money out?

A. I think that is, perhaps, what swayed the decision the way it went in the end. I do recall there were many, many discussions about that particular location."

One may well wonder why this hesitation was not in due course communicated to the trust company's directors; in any event, it was not shared by Facey who had his usual one-third of the shares of the new companies. The leasing problem was solved with alacrity on this occa-

³Exhibit 5104.

sion by a report from Shuyler, Ecclestone & Green that the Ford Motor Company was about to apply for 150,000 square feet in the Parkay building; this apparently justified a first advance of \$400,000 on November 21, 1963, after Pike had solemnly written to Calladine on November 18 to say that his request for an advance of principal without fulfilling the leasing requirements had been discussed "at great length with members of our Investment Committee and had been rejected".⁴ The Ford occupancy, in the event, only amounted to 28,200 square feet at an annual rental of \$23,970, as Facey advised Pike on December 6,⁵ but Hi-Way Warehousing was reported to have taken 75,000 square feet at \$75,000 per annum and the firm of Daigle & Paul of Montreal 100,000 square feet for \$95,000 per annum. The Ford and Daigle & Paul leases never in fact materialized, although execution and assignment of the Hi-Way Warehousing lease on December 6 was used to justify the final advance. For all practical purposes \$600,000 was advanced on the Parkay Investments building, with no collateral security in the form of genuine leases assigned to the mortgagee.

The sub-division of the Rutherford Road property was effected on February 4, 1964 by the grant by Parkay Investments of about one-half of the 15 acres involved to Trans-Swiss Investments, and the first advance of \$150,000 out of the contemplated \$600,000 made by British Mortgage & Trust on April 17. The leasing prerequisite was satisfied by Facey and Pike putting together the Hi-Way Warehousing lease of space in the Parkay building, on which the full \$600,000 had by then been advanced, and another lease to Two Seven Warehousing of 85,000 square feet in the projected Trans-Swiss building for ten years, with an annual rental of \$85,000, for a total advance in respect of the Rutherford Road property of \$750,000. The financing of this building was never completed, although a second advance was made on June 25, 1964 of \$300,000, based upon a Ford Motor Company lease for six months with an option to renew, and one from Butcher Engineering Company for the same period, to produce total annual rentals of \$40,608. Some rent from the Ford leases was in fact paid into the British Mortgage & Trust management account, but none, as might be expected, was received from Two Seven Warehousing either by the trust company or by Belfield Investments and the Butcher rent was paid to the latter. The final \$150,000 due to be advanced was withheld by British Mortgage & Trust because of the failure of Trans-Swiss Investments to produce further leases and the registration of mechanics' liens against title to its property on August 25. These two buildings in Brampton were eventually sold in September 1966 for a total price of \$1,365,450, made up of \$1,000 in cash with the balance secured by a first mortgage to Victoria and

⁴Exhibit 4802.

⁵Exhibit 4769.

Grey Trust Company for a term of eighteen years, so that an apparent profit of some \$22,000 was realized. It was in the course of their construction that Pike testified to having become aware of the fact that Calladine himself was the principal in Hi-Way Warehousing and Two Seven Warehousing, after a visit to Rutherford Road which disclosed that the space assigned to these enterprises was vacant. When asked if he had discussed the matter with Facey, he replied that he "imagined" that he had.⁶

Hi-Homes Limited—Flomar Securities Limited

In spite of Gregory's prohibition, one further mortgage loan was made to a Calladine company called Hi-Homes Limited which had previously been a borrower against mortgages on properties in Newmarket, Ontario, and was for this reason probably not consciously associated with the Belfield group. Facey held no interest in this company although, up until February 10, 1964, the Newmarket branch office manager for British Mortgage & Trust, Rudy Reiter, had been a director. The property which Calladine sought to develop through this vehicle was 51 Belfield Road, consisting of some two and a half acres purchased for \$43,000. The application for a loan of \$144,000 at 8% for twenty years was forwarded by H. McGroarty, of the Toronto mortgage office staff, to Pike on February 21, 1964 and was approved by the executive committee as a loan to "Hi-Homes Limited (R. G. Calladine)" on February 26. The first advance of \$70,000 was made on March 18 and the second of \$14,000 on April 6.¹ It was conceded by British Mortgage & Trust that advances in the total amount of \$84,000 would be forthcoming without the assignment of leases and on April 1 the property was conveyed by Hi-Homes Limited to Flomar Securities Limited, a company incorporated on March 3 for the benefit of the usual shareholders, R. G. Calladine, L. W. Facey and Richard Watson. On July 27 Maxwell Rotstein announced the lease of the entire building to Two Seven Warehousing and two days later this produced the final advance of \$60,000. No rental from the assigned lease was ever received by British Mortgage & Trust, but on September 2, 1965 the building was sold and the full amount of the mortgage realized from the proceeds of the sale. On the assumption that Pike was serious about the leasing requirements as prerequisites to advances on mortgage loans, it may be noted that out of the \$4,900,000 advanced by British Mortgage & Trust to the ten associated companies in the Belfield group some \$2,242,000 was obtained by the assignment as collateral security of leases made to companies or individuals which Calladine certainly, and Facey probably, knew to be worthless.

⁶Exhibit 4901.

¹Exhibit 4805.

The Bankruptcy of Belfield Investments: Comments of the Trustee and Auditors

This brief account of the mortgage investment of British Mortgage & Trust and the undertakings of Roy G. Calladine may be concluded by certain general observations before turning to a view of the activities of Pike, Facey and their relationship with the managing director of the trust company. It can be safely said that no advance on any mortgage to any one of the affiliated companies was ever permitted to rest entirely in its coffers for the purpose for which it was made; it was in part transferred to other enterprises which had fallen behind in either construction or mortgage payments. The general process of robbing Peter to pay Paul was matched by the efforts of Pike to postpone repayment and capitalize interest that was overdue and thus enable Wilfrid Gregory to maintain his position with the Registrar that none of the company's mortgages were in default, except those under which foreclosure proceedings had been taken. A general view of the situation at September 15, 1964, when the unsecured creditors of Belfield Investments, to whom it owed \$2,380,159, placed it in bankruptcy, was provided by the trustee, the Clarkson Company, which made, amongst others, the following observations in a letter of October 15, 1964 to the company's creditors:¹

"Belfield Investments Limited is a construction company which has constructed many buildings in the Toronto, Brampton and Newmarket areas during the last three or four years. Belfield owns one building which is located at No. 70 Belfield Road. Most of the other buildings are owned by separate companies but these companies, in turn, are owned by the same principals who own Belfield. With one exception, the various companies included in the Belfield group are as set out in Clause 8 of the Proposal and these companies are turned over to the creditors under the Proposal. Construction of some of the buildings owned by the property companies is complete but many of them are under construction. At the time of writing this letter, construction is stopped substantially on all projects and most projects have been heavily lienied by the trade. Some properties are fully leased to tenants while others have vacancies. All buildings are subject to substantial mortgages and a schedule of the mortgages against the various properties is included with this letter. It would appear that lien claimants would have little equity in most buildings in the event of a forced sale. We hope to conclude arrangements whereby the buildings will be completed by The Clarkson Company Limited as Trustee under the Mechanics Lien Act, and steps are being taken to achieve this end. This completion will accrue to the benefit of all parties who are involved.

We expect that Belfield Investments Limited is a creditor of each of the property companies. However, the accounting for the property companies and Belfield itself leaves much to be desired. Two years ago,

¹Exhibit 4532.

three of the companies issued audited financial statements. None of the other companies have ever been audited and the accounting records of all companies are non-current and incomplete. Accordingly, it is difficult to accurately determine inter-company indebtedness."

Two Calladine enterprises, one involving construction of a large building in Scarborough Township by Trans-Dallas Investments, which British Mortgage & Trust declined to finance but in which Canada Trust Company invested over \$1,000,000, and Ethnic Breweries Limited in Brampton, in which British Mortgage & Trust was also not involved, were included in the figures assembled by the Clarkson Company, but, looking only at those which concerned the mortgage loans of British Mortgage & Trust, it would appear that out of total mortgage financing of \$6,179,846 the principal owing to the trust company at September 15, by way of first mortgages, was \$4,851,646, and to Aurora Leasing Corporation on second mortgages \$845,000, all of which had been lent to Aurora for the purpose by British Mortgage & Trust. In consequence the total British Mortgage & Trust commitment was \$5,544,046 and the cost to complete the buildings in which British Mortgage & Trust was in a first mortgage position was estimated by the Clarkson Company at \$598,300. The auditors of the three companies which issued financial statements for the year 1962, referred to above, were Clarkson, Gordon & Co. and their audit file contains a memorandum from which quotations may usefully be made.² The first, dealing with Belfield Investments Limited, after making highly critical observations on the business methods of Calladine, concludes:

"The client, as noted at the beginning of this memorandum, has incorporated three companies for the purpose of obtaining mortgage funds. The mortgage company is restricted in advancing to any one company more than a stated maximum in any year. To circumvent this the three companies have been incorporated and mortgage payments are made to each of the three individual companies, although processed through the books of only one company. The Toronto manager of British Mortgage and Trust Company is Mr. L. W. Facey, the vice-president of Belfield Investments Limited, 60 Belfield Road Limited and 50 Belfield Road Limited and he is shareholder in all three companies."

An example of what disturbed the auditors may also be quoted.

"There were two payments in the year to Toronto Fence and Wire Company totalling \$1,235.10. \$435.10 was charged to the building account of 70 Belfield Road and was the cost of installing a fence at the home of Mr. R. Calladine on Greenbrook Drive. \$800 was charged to miscellaneous office expense and was the cost of installing a fence in the Don Mills home of the vice-president, Mr. L. W. Facey."

²Exhibit 5006.

The Participation of Facey and Pike and the Extent of Gregory's Knowledge

At the time that the main investigative work was being done in connection with British Mortgage & Trust Company by the Commission, from the end of 1965 to the end of 1966, L. W. Facey was out of the jurisdiction and was residing in British Columbia. His role in the Belfield group of companies was, however, a matter of interest to the trustee in bankruptcy of Belfield Investments and the following quotation from the examination of Roy Gordon Calladine for discovery, taken on April 14, 1965, some time before either British Mortgage & Trust or Atlantic Acceptance appeared to be threatened, is a sample of the type of co-operation which Calladine was prepared to give on this or any other matter:¹

"Q. How many shares did Mr. Facey own in Belfield Investments Limited?

A. I don't remember, Mr. Baird.

Q. Did Mr. Facey work full-time for Belfield Investments Limited?

A. What do you mean by 'full-time'?

Q. Did he work solely for Belfield Investments?

A. No. I don't think he did. I think he worked for other firms as well.

Q. Who else did he work for?

A. I don't know, Mr. Baird, all the companies he was associated with.

Q. What was his principal employment?

A. His principal employment?

Q. Yes.

A. I don't really know, to tell you the truth. I know where he worked.

Q. Was Mr. Facey manager for British Mortgage and Trust Company?

A. How do you mean?

Q. Was he the manager of the office of British Mortgage and Trust Company?

A. I don't believe he was manager of an office: I believe he was the mortgage manager, but not manager of an office.

Q. Was Mr. Facey employed by British Mortgage and Trust Company?

MR. ROTSTEIN: You might ask Mr. Facey.

Q. Did he work for commission or wages?

A. I never knew whether he worked on commission or wages; I don't know.

¹Exhibit 4350.

Q. Did you ever deal with Mr. Facey in dealing with mortgages in the British Mortgage and Trust Company?

A. I believe I did.

Q. What was his position when you dealt with him?

A. I always thought he was Toronto mortgage manager, but I do not really know.

Q. Was he paid a salary by Belfield Investments?

A. Yes.

Q. What was the salary?

A. There was no fixed amount.

Q. How was he paid?

A. There was no fixed amount.

Q. On what basis was he paid, if there was no fixed amount?

A. Well, he did numerous things for Belfield Investments, and from time to time he was paid money.

Q. Who decided how much he would be paid?

A. I think I decided what work he should do for Belfield Investments; he did various things for Belfield Investments in regard to negotiating leases, Mr. Baird.

Q. What leases did he negotiate?

A. I could not tell you at this time exactly, but he negotiated leases on the telephone with me, and counselled me two or three times a day, and at night-time; I believe he went to England for the company.

Q. What did he do in England?

A. He put an ad in the paper and tried to lease space.

Q. What was the nature of this trip to England—how long was it?

A. I do not recall.

Q. Did Belfield pay the expenses to England?

A. I believe they did.

Q. Did you go to England at the same time?

A. No. I did not. I did not fly with Mr. Facey, if that is what you mean.

Q. Were you over in England at the same time as Mr. Facey?

A. Part of the time, yes.

Q. Did Belfield pay the expenses of the wives—your wife and Mr. Facey's wife—to England?

A. I believe they did. My wife went over as my secretary; it was much better than asking Mrs. Henderson, because many people criticized her more or less, and Mrs. Love was far too busy running the company, or helping to run the company in Toronto to go over there.

Q. What role did the wife of Mr. Facey perform over there?

A. She was going to be in charge of entertainment, Mr. Baird.

Q. Who would be entertained?

A. Various officials—we would entertain officials with companies over there before signing leases.

Q. Mr. Calladine, I would like to show you a cheque in the amount of \$7,771.55, dated February 10th, 1964, drawn by Belfield Investments to L. Facey. Why was that cheque issued?

MR. ROTSTEIN: Can we see all four cheques?

MR. BAIRD: Yes.

THE WITNESS: On the corner of it it says 'To replace the December cheque,' and not having the books or Mrs. Love with me, as her memory is terrific, to advise me what this is for, what period this is for, it was most likely a wage cheque. We would be only too happy to check it out in the books for you.

Q. I show you a cheque dated April 30th, 1964, paid to L. Facey, in the amount of \$2,000, drawn by Belfield Investments, charge account. Why was that cheque issued?

A. It would most likely be payment of wages to Facey.

Q. I would like to show you cheque July 24th, 1964, in the amount of \$3,000, paid to the order of L. W. Facey, drawn by Belfield Investments. Why was that cheque issued?

A. That also, I would imagine, was wages for Mr. Facey.

Q. Did Belfield Investments perform any work or any services for any property owned by Mr. Facey?

A. It is quite likely that Belfield Investments did some work for Facey.

Q. What work did they do?

A. At this time I could not remember, Mr. Baird, but Mr. Facey did actually do a lot of work for Belfield Investments Limited, and worked with me quite hard and was always available, and it is quite likely that he might have had some work done for himself."

Later, on January 26, 1966, in the course of a voluntary examination under oath conducted for this Commission by Mr. Cartwright, Calladine condescended to give further information, assisted by his counsel, Maxwell L. Rotstein, from his experience of eighteen months in the practice of law.²

"Q. In addition to the remuneration you have already told me about, did Mr. Facey ever receive what I will, sort of say, consideration or

²Exhibit 3689.

benefits or additions from Belfield Investments Limited, such as a boat, summer cottage, outboard motor, anything like that?

A. You mean, did the company purchase him a thing?

Q. Yes.

A. I don't believe they ever purchased him a thing.

Q. Would they ever have advanced him moneys so he could have done this?

A. I don't recall at this time. Certainly when you are an officer of a company you get certain fringe benefits, in any company.

Q. Right. What was the policy, sir, that you were employing in your company with reference to these perquisites and fringe benefits for your officers?

A. Well, it's possible he had certain fringe benefits done for him.

Q. Could you give me an example as to the scope?

A. Well, I remember he had the carpenters build him a trailer one time, put some new boarding in a trailer. It's common in a company. I remember the carpenters building a piece of furniture for the superintendent, Joe Lanzino.

Q. May I ask you about a thousand bags of cement that went to Peterborough for Mr. Facey, would this be a perquisite?

A. I don't know. I never seen the actual invoice for that. I think if you are referring to it from that transcript there—

Q. Right.

A. And I don't remember it at this time. If the Clarkson Company have the invoice they should show it to you or show it to me and it would refresh my own mind.

Q. Just keeping with the policy of the company, I will assume this did in fact occur, that a thousand bags of cement went to Mr. Facey at Peterborough on the instructions of Belfield Investments Limited. Would this be the normal sort of perquisite that we are talking about that would go to a director?

A. Well, you could call it a fringe benefit. But, I honestly don't remember Mr. Facey getting a thousand bags of cement, at his cottage. Perhaps I should phone him up and ask him.

MR. ROTSTEIN: In any event, I do not think a law firm charges one of its lawyers for searching a title. In a construction business, if construction material goes to one of its directors, I do not think it is unusual.

MR. CARTWRIGHT: That is why I was asking Mr. Calladine if it was a normal perquisite in the operation of the company.

MR. ROTSTEIN: If we did I do not think it would be unusual.

MR. CARTWRIGHT: Is that right?

A. If we did I don't think it would be an unusual situation."

When the dialogue was resumed, more than a year later, it was under the aegis of the Securities Act and Calladine appeared under subpoena with different counsel. Although on these occasions—three in number—he claimed the protection of the Canada Evidence Act and the Evidence Act (Ontario), very little information was forthcoming, the standard answer to most questions being, “I do not recollect at this time”.³ These examinations were conducted privately and not in my presence, but I must, from my own knowledge of the facts on which he was examined, conclude that he was an evasive and untruthful witness.

In his managing director’s report for the year ended October 31, 1964, dated November 17 of that year, Wilfrid Gregory had sombre words to say about the Toronto mortgage manager.⁴

“I should probably include a brief comment about Larry Facey. Larry did an excellent job for us for ten years in looking after our Toronto mortgages. He was most energetic and his judgement as to values was sound. Unfortunately, one of our mortgagors, Mr. Roy Calladine, came between us. I could not help but feel that recently Mr. Facey’s loyalties were divided and that I could not rely on him to the extent I required. Therefore, it was with regret that I had to ask him for his resignation, which was forthcoming. There can be no compromise with absolute integrity and loyalty on the part of any employee in a financial institution.”

When A. V. Crate was appointed Toronto area manager in 1963, he had, according to Gregory, communicated to the latter the fact that rumours of an uncomplimentary nature were circulating about both Pike and Facey. It is important to know to what extent the managing director was aware at this point of their relationship with Calladine, as well as other borrowers by way of mortgage from British Mortgage & Trust. He admitted in his evidence to having learned, in or about October 1963, that Pike had acquired “a small European car at cost” as a result of the good offices of Hudson R. Elmore whose companies had been very substantial borrowers. He may have confused benefits received from Elmore with the purchase of a small sports car by Lucy Pike in May 1963 from A. M. Ecclestone for the sum of \$1,100, from the proceeds of the mortgage to Meyers Investments assigned to her by Belfield Investments.⁵ Pike admitted, on his examination on July 12, 1967,⁶ that while he was a director of Interim Building Credits Limited, one of Elmore’s companies, he had received a cheque for \$800, “supposedly for directors’ fees”, and had bought a new car by trading in his old one and receiving the difference in price from that company. However that may be, Gregory said that he “did discuss this with Mr. Pike

³Exhibits 4862-4.

⁴Exhibit 4281.2.

⁵Exhibit 5103.

⁶Exhibit 4901.

and emphasized with him the importance of not having any such dealings with people to whom we were lending", and he continued as follows his account of what transpired after Crate's warning almost a year later:⁷

"A. And I said, 'I am very surprised to hear that', and I said, 'Can you get me any evidence?' And he said, 'No, I haven't heard anything more than that.' I said, 'Fine, I will keep that in mind'. Once again, I spoke to Mr. Pike, without naming himself or Mr. Facey. I said, 'I have been told that there have been suggestions that some of our mortgage department people had been acting improperly and would you check up with everyone of them and emphasize the fact that this can't be permitted.' And those are the only two suggestions I ever got that there was any wrongdoing.

Q. I take it the improper actions to which you refer would involve the receipt of a benefit from someone with whom they were dealing in connection with a mortgage to be approved, or otherwise dealt with, by them?

A. That is correct.

Q. Turning to Mr. Facey, whom you mentioned, there is evidence before the Commission to the effect that British Mortgage made a substantial number of loans to companies which we have called the Belfield companies, these being companies who were either subsidiary to or allied with by means of common ownership a company called Belfield Investments Limited; and the evidence has been that by July of 1965 the aggregate of all sums outstanding in connection with these loans were in the order of \$4,900,000. The evidence was further that Mr. L. W. Facey, the mortgage manager of British Mortgage—

A. In Toronto.

Q. —in Toronto held beneficially a one-third interest in these various companies. The evidence is also to the effect that in the late summer of 1964 Mr. Facey was dismissed or, at any rate, his employment was terminated by reason of dissatisfaction on the part of the company with respect to the extent of his involvement with these Belfield loans. Can you assist the Commission, first, as to whether the company was aware of Mr. Facey's ownership of shares and whether any objection was taken to that; and, secondly, what it was that the company objected to which led to the severance of Mr. Facey from the company?

A. Yes. Mr. Facey was a very valued man down here and, as the pressure of money, getting our money out, grew, as we began to get in millions of dollars each year, we finally got out thirty million in mortgages in 1963 and thirty-five million in 1964, this was the sort of volume that was being done. With Elmore we first ran into him when he was building an industrial type building to be leased to smaller tenants.

Q. Would you mean Calladine?

A. Calladine.

⁷Evidence Volume 116, pp. 15834-7.

Q. This is Belfield?

A. Yes, Calladine was the president of Belfield. It seemed like a pretty good idea and we considered it and talked about it and we went in on the basis of 8 per cent loans and the fact there had to be leases of a certain percentage of this space before we would advance all our money. After completion it would be so much and, then, there would be further advances on the basis of the leases being signed up.

Q. Who was the British Mortgage employee directly concerned with that?

A. Well, Mr. Facey was, although he reported to Mr. Pike in Stratford, and so on. And that went along quite well. The second one they built for Dominion Stores and there was a wonderful lease there, although it was short in term. There were four or five of them and, then, I began to get the feeling—Well, first of all, I guess I should say, I think it was in 1963 some time, Mr. Facey had been overworking and wasn't well and I said to him, 'You seem to be doing an awful lot of work in these Calladine loans. You shouldn't have to do that. Maybe you need more help'.

He said, 'I don't mind; I am working things out and I am helping Calladine, looking after his books.' I said, 'I hope he is giving you something for doing that extra work?' And he said, 'Well, he gave me some shares.' To that extent I knew he had an interest in these companies but it was casual—and I didn't think anything about it.

Q. Did he tell you the proportion?

A. No, but he was doing a lot of work for them and these were going along fine until I began to be concerned about the fact that Mr. Calladine seemed to be drawing money from new buildings in order to finish off the work on old buildings, and I discussed this with Mr. Pike and said, 'I am afraid we have to stop dealing with Calladine, even though the business is profitable and the work generally good.'"

He maintained that it was not until the bankruptcy of Belfield Investments in September 1964, when he went with Crate to see W. A. Farlinger of the Clarkson Company Limited, that he discovered that Facey had a one-third interest in the Belfield companies and was receiving a salary from them of some \$8,000 a year, "almost as much as he was getting from us". His account continued:⁸

"A. . . . So, then, Mr. Pike and I took over and saw Mr. Facey, he being—Mr. Pike being mortgage manager, and I pointed these things out to him and he said he told me he had some shares. I said, 'Granted you did, but I had no idea of the extent of your interest to any particular. I am afraid it has affected your judgment now', whether it did or not. And he said he didn't know some of these things. I said, 'Whether or not it did in fact affect your judgment I can no longer trust you and I am afraid I will have to ask for your resignation', which was forthcoming.

⁸Evidence Volume 116, pp. 15839-43.

Q. Now, according to evidence before the Commission Mr. Facey was the person who commonly valued these various buildings for mortgage purposes?

A. That is correct, and he was very competent when he was doing—

Q. And as you have already said, as local mortgage manager, the person charged with the responsibility of deciding when it would be appropriate to make advances. Is that correct?

A. Yes, that is correct.

Q. When he told you in 1963 that he was doing work for Belfield and had some shares did you turn your mind at all to the question of whether it was wise to allow him to do that or if he were allowed to have any interest whether it was wise to permit him to continue either to value or to inspect?

A. I am afraid it just didn't occur to me because I was so used to looking at a deal and coming up with an honest decision on the facts that I just never thought but that he would do exactly the same thing, and I am not sure yet that he did not do. So, I didn't give any attention to that. I thought, 'Well, Mr. Calladine is giving him something for his extra bookkeeping and trying to raise him second mortgage money, and this sort of thing', and that is all. He has told me this. Now, if I may go on with one further thing?

Q. Please do.

A. Mr. Pike told me a little later, maybe the beginning of 1964, or something—I guess I had told him to get out, to resign as a director of Belfield and get themselves out. I am not exactly sure of the date, but I didn't like it. So, he had been to Mr. Calladine and told him he had to get out as a director and sever his interest, and then there came a question of how he was going to get his interest out, his money, and he did in fact, through Mr. Pike, let me know that they were prepared to turn over to the company anything he made over a certain reasonable amount that I might set, which I thought was very decent, very straightforward. I said, "Well, after you get a settlement with Calladine and get your money out we will decide what is fair to everybody'.

Q. Did this discussion take place substantially at the time that you asked for his resignation, or is this some discussion that took place earlier?

A. No, about the time we asked for his resignation, I would think.

Q. After it came to your knowledge from your conversation with Mr. Farlinger?

A. No, no. I am sorry, not that resignation. The resignation where I asked him to resign as a director of Belfield, which was back a year—well, some months before the bankruptcy, just when I was getting a bit upset about Belfield. A bit concerned.

Q. Now at that stage did you ask him what is the extent of his interest?

A. No, I did not.

Q. Or did you deal with the question of how much money, in dollars, he was likely to get?

A. No. He didn't know. It was awfully hard to put a value on them and to decide what the equity was worth in these things because they had started from nothing. But, Calladine was developing a very nice situation, where value was added to his project when he got them built and got them leased because, then, you valued the building on the lease and a lease to Dominion Store with what he got would be worth 50 per cent with the same building empty. And Calladine would get this value and Facey would be entitled to some of it. Bill just told me that Larry had told him it was building up to more than he ever expected and he was prepared to see the company get most of it if they got liquidated. It never was liquidated.

Q. I wonder why you would not direct a question to him when you learned that he was working for the company and had a share interest as to the amount of his salary and the amount of the interest which he had?

A. I suppose it is the first time I had ever run across something like that and I did feel he was entitled to be compensated and I just couldn't conceive of him having any conflict of interest with us, where he had been for many years and had been our mainstay. Just because some other mortgagor comes along and for the moment, for awhile is asking him to lend him the thing, I couldn't see the conflict, I couldn't conceive it. I may have been naive."

Both Facey and Pike have testified about these events on oath, although at some time after the date of Gregory's evidence before the Commission and not at its public hearings. Facey resigned as a director and vice-president of Belfield Investments on August 5, 1964, on Gregory's instructions, over a month before the bankruptcy proceedings which led the latter to consult Farlinger. According to Facey's evidence he was told that this step was sufficient and that he could keep his shares. In considering his account of what he called "trying to ride two horses" it should be remembered that he had succeeded to the position occupied formerly by H. W. Patterson, in which the latter had been allowed to continue his own independent business while acting as Toronto mortgage agent for British Mortgage & Trust, and that Facey held his own real estate broker's licence. He had what follows to say about the extent to which his position with Belfield was known at Stratford:⁹

"Well, looking back on the whole Belfield episode, it was during this very busy period of plentiful money, of lots of activity in the trust company business, British Mortgage was growing at a rate that had never been heard of before, under some dynamic management. We were all working hard, assuming responsibilities, assuming other duties than what were our normal course of events. I was in the position of being a

⁹Exhibit 5119.

director of Belfield Investments. I had discussed my participation in it with Mr. Ecclestone at the very start. I had discussed it with Mr. Pike who later advised me that he had spoken to Mr. Gregory about my participation and that everything was clear. They thought it was a good thing. Not satisfied with this method I waited until an occasion arose where I was in Stratford and I put this to Mr. Gregory at the very start; I had been invited to join a construction company, these fellows have built three buildings and now on another one, they think I can be of some help to them, and his comments were, Larry, go right ahead, make sure you get enough out of it."

At a point which he identified as being in the spring or summer of 1964 he apparently had misgivings and felt that Gregory should consider the matter more closely.

"What had started out to be a share in a small forty thousand square foot building—eighty thousand, I beg your pardon, now turned out to be a giant of a company. I could sit back and look at this and realize that we were now into the millions of square feet, into the millions of dollars, although I was in it since 1961 it dawned on me that here I was virtually a third owner of an almost giant which was far beyond my scope.

I relayed some of these things to Mr. W. P. Gregory at a meeting in Stratford. It was an office get together of some kind when I had an occasion to be sitting next to him at a luncheon or dinner. I told him some of these things I told you now. I had told him that Mr. Calladine was a man of mystery to me, that he was a potent man, that he got these buildings up and we had them occupied and we had some cream for tenants. It was very—now—saleable buildings and my small participation in the start had suddenly grown to a third of, I don't know what. I mentioned to Mr. Gregory, perhaps it is fifty, perhaps it is two hundred, perhaps it is five thousand, I said, Mr. Gregory, this is now what I am part of and I said, Facey as such, hasn't done as much to deserve this. I said it is British Mortgage money, know how, and gamble, if you want, that has brought us to this stage. Now, I am holding such a large piece of this great big company and I said it is—it really—I don't deserve this much credit, Mr. Gregory. I had been paid for what I have done and I think I have been well paid for any contribution I have made but I am certainly not entitled to a third of the equities that are now in these buildings. I think this rightfully belongs to British Mortgage & Trust more than to Facey and Mr. Gregory said, of course, British Mortgage couldn't own one third of this big company and he mentioned a separation or a ratio of ownership that possibly, if the occasion arose in the future, could be an amicable one. It appears to me, he said, Larry, about the way we could do this would be perhaps forty percent to you, forty percent for Bill Pike, because I know Bill has done an awful lot of work, has spent a lot of time on this with you, you both have been in head over heels and twenty percent for us and that gave me food for thought; even forty percent was more than my wildest hope that this thing had ever grown to."

This evidence was given in October, 1967 and in February 1968, when Mr. Cartwright re-examined him, Pike said that he remembered the occasion, although not overhearing the conversation, and recalled a subsequent discussion with Facey as to the division of the latter's interest in the Belfield shares. According to Facey, Pike had said, "Larry, Wilf is usually very fair in these matters". Nothing had ever been reduced to writing and Pike said that he thought "Mr. Gregory was treating it in rather an offhand fashion". When on September 18, 1964 Facey was visited in his office by Gregory and Pike and told by the former that, because of his connection with Calladine, his employment by British Mortgage & Trust was at an end, Pike said that he was "emotionally upset" and, one might think, with some reason. Facey felt that Gregory's mind was made up and nothing he could say would change it. In any event he tried.¹⁰

"There are many things said in the heat of the moment of the evening of my demise with British Mortgage. Many of these things are hazy to me, some of them stand out. It seems to me that I brought up the fact to Mr. Gregory, was I not fair with you when I told you that I would be—that I was willing to throw all of this at you and it was you that came back with a division, not I. I told you, Mr. Gregory, that I hadn't earned this, that I was getting well paid for what I did and I gave that to him that evening and I just forget what his response was."

Pike also confirmed the accuracy of this observation and, after the blow had fallen and the three men were leaving Facey's office at 2200 Yonge Street, Facey recalled the final conversation.¹¹

"... We also talked about my share participation with Belfield Investments and it comes to mind that this share was talked about very briefly on that Friday evening in that when we had both said about all we had to say we were leaving my office and walking towards the banking chamber of British Mortgage's office and I said to Mr. Gregory, 'Wilf, whatever will I do?' He said, 'Larry, you know an awful lot about Belfield and the buildings, and so forth, and Clarkson Gordon are now handling it, they could probably use you in some capacity.' I said, 'Oh boy, after all this you would not wish that on me, would you?' So I said, 'What are the mechanics? What is going to happen now, Wilf?' He said, 'Well, probably you will be asked by Clarkson Gordon to hand your share over to'—I think he used the word 'nominee' or somebody. He said, 'They will take over from there. Really, that will probably end it for you.' I said 'should I mention when this comes up, Wilf, that, in truth, I was only partly owner of this share and that there had been some discussion, that, perhaps, in the future, if the circumstances arose, there would be a three-way split of this share?' His answer was, 'Oh, no, no, Larry, there is no need to mention anything about that.'"

¹⁰Exhibit 5119.

¹¹Exhibit 5120.

This was also put to Pike by counsel, reading from the transcript of Facey's evidence, and the following exchange took place:¹²

"Q. . . . Have I read that correctly, sir?

A. Yes.

Q. Do you remember that conversation?

A. Yes, it was in the office just outside Mr. Facey's door.

Q. And that is a correct résumé of the conversation?

A. I think it is quite accurate.

Q. Now, what about this business of not mentioning it to Clarkson Gordon and Company, how did that strike you?

A. Well it struck me that Mr. Gregory didn't care to have Clarkson know that anybody but Mr. Facey was involved. I would think."

There is sufficient correspondence in all these accounts to show that Facey had never concealed his participation in Belfield Investments from Gregory and that it was the extent to which he had benefited, and the fact that Clarkson's were in possession of the facts as to his holdings in all the Belfield companies, which caused Gregory to dismiss him. As to the division of benefits between Facey and Pike, I consider that their account, given under oath, has the ring of truth. It may be that Gregory never seriously addressed himself to the problem of British Mortgage & Trust taking a 20% interest in Facey's holdings; indeed there would have been some difficulty in explaining the situation to its board of directors, particularly in the case of Pike whose terms of employment could not on any grounds be deemed to include participation of this kind in the potential profits of a borrower. There is no doubt in my mind that Pike was treated with unnecessary and inexcusable indulgence in this and in other episodes which will be related, and in which Gregory was in no position to make a protest. Facey would appear to have been treated in the same way up to the point where his activities became an inconvenience, and perhaps a threat, to Gregory himself.

A final word may be said about the scale of the benefits received from Calladine by Facey and Pike. Facey produced his income tax returns for the years 1961 to 1964; he first reported earnings from Belfield Investments for the year 1963 of \$10,770.80. In the same year he received \$10,670.08 as salary, \$1,500 as car allowance and \$1,560.06 as commission from British Mortgage & Trust. For 1964, up until September 18, he reported salary from British Mortgage & Trust of \$8,500, car allowance of \$1,250 and commissions of \$250.78, compared with receipts of \$5,500 from Belfield Investments. He admitted holding a British Petroleum credit card in the name of Belfield Investments and estimated that he benefited by this to the extent of \$1,237.71 during 1963,

¹²Exhibit 5104.

and up to August 5, 1964, mostly spent for Belfield business. The wire fence constructed at his house in Toronto has already been referred to as coming to the attention of the auditors of Belfield Investments and, in addition, Facey admitted that this company had installed cedar siding on a cottage owned by him at Rice Lake, and some steel beams, roofing pans and steel rails for his boat-house at a cottage later owned by him on Lake Simcoe. He maintained, however, that on the visit to England with the Calladines he had paid his own living expenses there and, for this reason, Belfield Investments paid his wife's fare. He had made from time to time small loans to Belfield Investments, the last one being in July of 1964, repayment of which he had only secured as a matter of great urgency, just before the company's bankruptcy, by tracing Calladine's signature on a direction to make the payment out of funds held by British Mortgage & Trust for Belfield Investments in its property management account. In addition to the \$3,614.90 paid by Margaret Facey to Lucy Pike, the Pikes received the benefit of having the recreation room in their house in Stratford paid for by Calladine, or one of his companies, to the extent of some \$1,500 to \$1,700.¹³ For a year Pike, also, had a British Petroleum credit card issued to him by Belfield Investments, but none of these advantages, derived from his position as mortgage manager, were novelties to him, since he had supplemented his modest salary (in 1964 \$9,200 as compared with Facey's of \$10,200) in this manner and on several occasions in previous years. As he had before the Commission in the case of the bribes taken by him from borrowers in London, he made a clean breast of many of these transactions in his examination under the Securities Act from which the following may be quoted:¹⁴

"MR. CARTWRIGHT: Back on the record, Mr. Pike, did you cause to be opened at the Bank of Montreal in Kitchener a savings account, No. 3582, in December of 1959?

A. I prefer not to answer, as it may incriminate me.

Q. Mr. Pike, I will direct you to answer the question, but in view of the position which you have taken with reference to this question, and I assume you will take with reference to any other question, arising out of this topic, I will grant you the protection of the Canada Evidence Act and the Ontario Evidence Act, which I note for the record, and now require you to answer the question.

A. Fine.

Q. Did you in fact open this account?

A. Yes.

Q. And, Mr. Pike, were the large credits to this account, being six in all, in the amounts of \$100.00, which in fact represented net deposit of a receipt of \$500.00, of which \$400.00 was received in cash, a hundred

¹³Exhibit 4901.

¹⁴Exhibit 4901.

dollars was deposited, a further deposit of \$500.00, and a further deposit of \$600.00, a further deposit of \$400.00, a further deposit of \$1,700.00, and a further deposit of \$1,500.00, in the period December 17, 1959, to October 21, 1960—do they properly reflect the personal receipt by you of funds from R. E. Hart Real Estate Limited, which was consideration accepted personally by you, in the result of which mortgages were granted by British Mortgage and Trust Company, with your approval, to certain mortgagor clients of R. E. Hart Real Estate Limited?

A. Yes.

Q. And did you in fact use these funds and dispose of these funds for your own personal purposes?

A. Yes.

Q. And did you pay any portion of these funds to any other person?

A. No, I didn't.

Q. Mr. Pike, do you remember being a shareholder of a private Ontario company, Old York Lane Properties Limited?

A. Yes.

Q. And do you remember, Mr. Pike, that on May the 4th, 1961 you received from Messrs. Gauld, Hill and Kilgour, by their trust account cheque No. 84, the sum of \$5,000.00, which was paid to you on behalf of Old York Lane Properties Limited as a payment for your personal endeavours in obtaining for that company a mortgage from British Mortgage and Trust Company?

A. Yes.

Q. And do you remember, Mr. Pike, that of this \$5,000.00, \$1,000.00 was given by you in cash to Mr. L. W. Facey, the Toronto mortgage manager of British Mortgage and Trust Company, who had made the evaluation on this property?

A. Yes.

Q. And do you agree with me that this was strictly a payment made personally to you on behalf of Old York Lane Properties Limited, and the thousand dollars which you gave to Mr. Facey for the participation of the two of you, in ensuring that the company would receive the mortgage funds from British Mortgage?

A. Yes."

The 1966 Amendment to Section 142 of The Loan and Trust Corporations Act

By an amendment to section 142 of the Loan and Trust Corporations Act enacted in 1966¹ the door was closed to the practice whereby separate but related companies could be incorporated to obtain, by way of mortgage advances from a trust company, more money than the limi-

¹14-15 Elizabeth II. c. 81, s. 13.

tation on investment in any one company would have permitted. The relevant portions of the section now read as follows:

"142. — (1) On and after the 14th day of April, 1925, no corporation shall,

(a) except as to securities issued or guaranteed by the government of Canada or the government of any province of Canada or by any municipal corporation in Ontario. . . .

(ii) make a total investment in any one bank or company or in companies that to the knowledge of the corporation are associated maturing in more than one year, including the purchase of its stock or other securities and the lending to it on the security of its debentures, mortgages or other assets or any part thereof, of an amount exceeding 15 per cent of its own paid in capital stock and reserve funds. . . ."

The device used by Calladine, with the acquiescence, and perhaps at the suggestion of officers of British Mortgage & Trust, to circumvent the limitation in section 142 as it formerly existed, and the searching examination of its affairs which occurred in the summer of 1965 were, more than anything else, responsible for the increase of legislative stringency in this and other sections of the Act.

* * * *

The I.G.A. Stores—West Lorne and Owen Sound

Two transactions of modest proportions but regrettable significance now fall to be considered. The first dealt with in evidence before the Commission was the subject of an application, dated March 26, 1962, for a loan of \$35,000 made by W. A. Pike, to be secured by a mortgage of property in West Lorne in the County of Elgin, on which a new food market of the Independent Grocers Alliance had been built and leased to Foodway Distributors Limited for twenty years at \$4,680 a year. On the back of the application form was the usual property valuation, in this case for \$52,500 and signed "W. P. Gregory."¹ The abstract of title for the land at the corner of Graham and Maple Streets in West Lorne² shows that on December 13, 1961 it had been conveyed by one Albert Hazelwood to William A. Pike by a deed to uses; the requirement for Mrs. Pike to bar her dower in any reconveyance was thus dispensed with,

¹Exhibit 4378.

²Exhibit 4379.

BRITISH MORTGAGE & TRUST

and the agreement for purchase and sale in the files of Anderson, Neilson, Ehgoetz, Bell, Dilks & Misener³ shows that the purchase price was \$46,000, \$1,000 as a deposit and the balance "of approximately \$45,000 in cash, subject to adjustments, and payable on completion of construction of the building or upon occupancy, whichever is sooner". This agreement was dated November 22, 1961 and on the following day a lease was entered into between Pike and Foodway Distributors. Six months later, on May 30, 1962, Anderson, Neilson & Co. reported to Pike that the balance payable on closing the deal with Hazelwood was \$44,931.09. After receiving the proceeds of \$35,000 from the mortgage from British Mortgage & Trust, which was not executed until March 29, Pike had about \$10,000 to pay, a sum which he obtained from Wilfrid Gregory by cheque drawn on March 30, 1962, payable to the Anderson firm.⁴ On the same day Gregory drew another cheque in favour of Pike for \$1,000 which might appear to be the amount expended by the latter for the deposit on the West Lorne property, but accounting for this payment must await examination of another transaction. Having purchased property for \$46,000 by the end of March, Pike proceeded to sell it to British Mortgage & Trust for \$52,000, conveying it to his employer by deed dated May 23 and registered on May 24, 1962. It was bought as an investment for the John Gaffney Construction Company Limited Pension Fund, for which the trust company acted as trustee, and the following letter illustrates this aspect of the transaction:⁵

"British Mortgage & Trust Company,
10 Albert Street,
Stratford, Ontario.
Attention J. M. Armstrong, Esq., Q.C.

Dear Sir:

Pursuant to our telephone discussion today, I hereby authorize and direct you to purchase from W. A. Pike of your Company, as an investment for the John Gaffney Construction Company Limited Pension Fund, the West Lorne Ontario I.G.A. Store at the price of \$52,000.00, subject to the outstanding mortgage of \$35,000.00.

We understand this property is presently owned by your Mr. Pike who acquired and developed it as a personal investment at a total cost to him of approximately \$49,300.

It is also understood that this property is leased to Foodway Distributors Limited with the guarantee of M. Loeb Limited for 20 years at \$4,680.00 per annum. By the terms of the lease agreement the tenant will pay for all taxes, insurance, lot and building maintenance, etc.

Yours very truly,
JOHN GAFFNEY CONSTRUCTION COMPANY LIMITED
'O. J. Gaffney' "

³Exhibit 4380.1.

⁴Exhibit 4383.

⁵Exhibit 4385.

Anderson, Neilson & Co., who had acted for Pike as purchaser and had been instructed on May 18 by Roland R. Swanson, trust officer of British Mortgage & Trust, to act for it as trustee of the Gaffney Pension Fund on the subsequent purchase from Pike,⁶ reported on both transactions to Pike himself on May 30.⁷ Douglas A. Bell of that firm, after stating that their account had been apportioned between Pike and British Mortgage & Trust, forwarded to the former a cheque for \$16,491.53 pursuant to the following adjustments:

"Received cheque W. P. Gregory	10,000.00
Received cheque British Mortgage & Trust Company—mortgage advance	35,000.00
Paid A. F. Fennell & Sons pursuant to Direction	10,800.00
Paid Albert Hazelwood	34,131.09
Received balance due on closing re sale to British Mortgage	16,761.95"

A. F. Fennell & Sons were substantial lienholders against the West Lorne property and were thus paid off.

It will be observed thus far that Gaffney knew that his company's pension fund had purchased this property, with its valuable lease, from the mortgage manager of the company which acted as its trustee and that, in accordance with the terms of his letter, he had so informed J. M. Armstrong, Q.C., its assistant general manager and the head of the trust department. More will be said later about this letter and the action taken by Armstrong, but it is sufficiently clear that Gaffney did not know that the cost of the West Lorne property to Pike was not "approximately \$49,300", as therein set out, but \$46,000. Certified copies of the ledger cards of W. A. Pike's three accounts with British Mortgage & Trust Company were supplied to the Commission, duly certified in photostatic form,⁸ and show that a deposit of \$16,491.53 was made in his account, No. 17213A, on May 30. This was a collateral savings account, such as the company usually opened on behalf of mortgagors for the receipt of rents and other moneys. No explanation based upon any combination of figures can account for the figure of \$49,300, attributed in Gaffney's letter to Armstrong to the purchase price paid by Pike, which, allowing for interest and solicitors' fees, could not have exceeded approximately \$46,500. The board of directors of British Mortgage & Trust confirmed on May 29 the executive committee's approval of the purchase without comment.⁹ The proceeds of the sale, which remained in the hands of Pike, were distributed at the end of May and their destination is revealed in a

⁶Exhibit 4380.3.

⁷Exhibit 4380.2.

⁸Exhibits 4386-8.

⁹Exhibit 109.

BRITISH MORTGAGE & TRUST

letter dated May 31, 1962 from Pike to R. E. Hart of Kitchener, Ontario, whose name has appeared in the last quotation from the transcript of Pike's evidence. Hart was a real estate broker and was examined under the Securities Act on August 17, 1966.¹⁰ On this examination he produced the original letter.¹¹

"Stratford, Ontario,
May 31, 1962.

Mr. R. E. Hart,
1243 Queens Boulevard,
Apartment #205,
Kitchener, Ontario.

Dear Bob:

Re: IGA Stores, West Lorne,
and Owen Sound

As you know, the sale of the Owen Sound Store was completed some time ago. The proceeds here were \$7,982.13.

Mr. Gregory loaned me \$3,017.87 in order that we could complete the purchase of West Lorne.

I arranged a mortgage with British Mortgage on West Lorne and collected rents from IGA for April and May.

The West Lorne Store was sold yesterday and after payment of mortgage interest and Mr. Gregory's loan I was left with a total of \$13,917.51. This was divided four ways as shown below:

W. P. Gregory	\$3,479.38
W. A. Pike	3,479.37
R. A. Palmer	3,479.38
R. E. Hart	3,479.38

I am pleased to enclose my cheque to your order for \$3,479.38 being your share of what I consider a very successful venture. It was not without some hard work but we have been adequately rewarded.

Yours very truly,
'Bill'
W. A. Pike"

The singular arrangement revealed by this letter was a partnership formed to solve, and to solve profitably for the partners, a problem of real estate financing about which Hart had a good deal to say on his examination. After referring to an agreement dated June 29, 1960 between Noy Construction Limited of the first part and ~~Horne and Pitfield Foods Limited~~*, M. Loeb Limited and Foodway Distributors Limited of the second part, which he produced and entered as Exhibit 3 to his examination, he responded to Mr. Cartwright's questions as follows:

"Q. How did Exhibit Number 3 come into your hands, Mr. Hart, was it given to you by someone?

¹⁰Exhibit 3706.

¹¹Exhibit 3706.1.

A. Oh yes, sure, what's the name of the solicitors? I negotiated this for a group in Noy Construction with I.G.A. and this was actually one of the copies that I had of an Agreement and it was my job then to try to arrange mortgaging on these stores which we couldn't just do; Dawson Creek Caver, Alberta—we just couldn't get financing for them. This fellow—then I had a call, could we handle some local stores because this was the problem here with distance, one thing and another I said I could try and there was Owen Sound, West Lorne and Forest, Ontario were the three at that moment they were trying to get out on a lease-back. I tried Canada Life, Prudential, all the other ones and finally went to British Mortgage.

Q. Yes, and what were you endeavouring to obtain from British Mortgage?

A. Sell them, sell the lease-backs to British Mortgage.

Q. And could you explain to me how you mean by 'sell the lease-backs'?

A. Well, for instance I.G.A. Stores built all their own properties at that time and they didn't say, 'Look, I want a store and here is a parcel of land, I want a store built on it and I am willing to pay so much rent for the store', they used to build the stores for themselves and this way they knew exactly what the cost was, then they set up their own rentals and they said, 'Here, you can have this store for a hundred thousand dollars as an example and we will pay ninety-five hundred dollars a year rent for it'. They told you. Usually the normal way is that the Company will come along and say, 'I want a 10,000 foot plant built in this area' and you go out on the location and price out the plant and tell them what rent they are going to have to pay. I.G.A. finished their own stores first and then said, 'Okay now can you get us a hundred thousand dollars and we will pay this kind of a rent for it'.

Q. Right, was the idea that B.M. & T. if I can refer to British Mortgage and Trust Company as 'B.M. & T.', B.M. & T. would actually purchase properties as—

A. Correct.

Q. —as an investment?

A. As an investment.

Q. All right. Could you tell me please who did you discuss this first with at B.M. & T.?

A. Mr. Pike.

Q. Then would you continue on, please, starting with your first discussion?

A. I can't recall why he turned them down, the only thing that is in my mind is at that time I remember him stating that under the Trust Act, if I recall correctly a Company—they had to be Triple A to start with and they had to have paid dividends within the last year or so many years, I believe it was a number of years from the date previous they

had to have paid dividends before a Trust Company could purchase them. The only other point that comes to my mind is that with this particular 3 stores the reason any other company let's say Prudential Life or them wouldn't touch them at the time is because they were small towns, very small places and they felt that they would prefer them in places like Toronto and so on. British Mortgage would take them in these particular areas providing the rates were high enough. One of them I believe I recall was at 10% and the other ones were less than 10.

Q. Now, by 'rate' you mean the—

A. Return.

Q. The rate of return?

A. The rate of return . . .

. . . And anyway he turned them down and he said they couldn't for some reason or other. As I say the other two things that come to my mind was the fact of rate and this other he was always, if you ever took anything to him, was always the Trust Act or Charters Act or something.

Q. Would the Loan and Trust Corporations Act be one Act?

A. No, he never mentioned that, it was always the Charters Trust Act.

Q. I see, that's all right.

A. I am not exactly sure what he called it. I know it was the Act that governs the Trust Companies, what they could deal with and what they couldn't.

Q. All right then, what happened?

A. Well I was—I had taken them just about everywhere at this point. I was about to give up when they said, he called me down, he said there is a possibility they might find a purchaser for them and what did I want out of it, and I said I wanted my regular commission so he said what they had in mind was and he took me in at this time and introduced me to Wilf Gregory.

Q. This is in the offices of British Mortgage and Trust in Stratford?

A. Yes.

Q. Yes, what happened?

A. And said he had spoken to Wilf about these and they thought, they felt they could sell them through some connections they had to possibly some overseas people and the only problem was they had no idea just what they would get. It would be a case of having to put them out and see what they could come up with and so they said that they had in mind it would be a gamble how much would come out and they couldn't guarantee me a full commission but then again I might get more than a full commission. This time I said, as I say I couldn't please them so I went along with them and they called me back and asked me if I would come down to a meeting. I went down and Mr. Reg Palmer was there so they introduced to me, Mr. Palmer."

After further explanatory detail he identified two handwritten documents on the letterhead of British Mortgage & Trust Company dated July 17, 1961 as being written, signed, and handed to him in the presence of Wilfrid P. Gregory, W. A. Pike and Reginald A. Palmer, which were afterwards put in evidence before the Commission by Mr. Walker and the first of which reads:¹²

"July 17, 1961

I hereby declare that I hold in trust all rights, title and interest of, in and to the property in Forest, Ont. being built for I.G.A. on which I have advanced 2,000.00, for the following in addition to myself, the four sharing equally.

Wilfrid P. Gregory
Robert A. Hart
Wm. A. Pike
'R. A. Palmer' "

The second document was similar and was signed by Gregory.¹³

"July 17th 1961

I hereby declare that I hold in trust all rights, title and interest of, in and to the property in Owen Sound being built for I.G.A., on which I have advanced \$2000, for the following in addition to myself, the four sharing equally:

Robert Hart
Wm. A. Pike
Reg. A. Palmer
'Wilfrid P. Gregory' "

There were accordingly three I.G.A. stores to be financed in the unusual way described by Hart, and it is sufficient for this account to say that the one in Forest, Ontario, was not purchased by the partners because of defects in the title to the lands involved, but that the transaction in Owen Sound, Ontario was indeed undertaken and somewhat earlier than the West Lorne project.

By deed dated October 27, 1961, Dising Limited conveyed to Wilfrid P. Gregory part of lot No. 1, plan 535 for the Township of Derby in the County of Grey, for \$133,000. In this case, as in that of West Lorne, a lease of the property to Foodway Distributors Limited, with M. Loeb Limited signing as guarantor, was given by the new owner for twenty years. Messrs. Marron & Keon, solicitors in Owen Sound, were instructed by Pike to act for Gregory on the purchase of this property, on which an I.G.A. store had been built,¹⁴ and in his letter he said, "We have made arrangements to have \$131,000 sent to you on November 30th. It

¹²Exhibit 3706.2.

¹³Exhibit 3706.3.

¹⁴Exhibit 4394.1.

will probably come from Atlantic Acceptance." It came in fact from Commodore Sales Acceptance on that day.¹⁵ Also in Pike's letter was the sentence: "It is Mr. Gregory's intention to dispose of this property within the next six to eight weeks and we may call on you to act again if this sale is to be consummated". The deposit of \$2,000, which was paid to the order of Stanley Kazman in Toronto, solicitor for the vendor to Gregory, was evidently made up of the \$1,000 paid by Pike to Gregory on July 17, 1961,¹⁶ and deposited in Gregory's account No. 10330 at British Mortgage & Trust,¹⁷ and \$1,000 from Gregory, the total amount being paid by Gregory to Pike on August 3¹⁸ and forwarded to Kazman. When finally acquired, the Owen Sound I.G.A. store property was only held by Gregory for some two months and then sold to Midland Distributors Limited for \$140,000,¹⁹ so that a gross profit of \$7,000, subject to adjustments, was the result. Midland Distributors, according to the correspondence, was a company operated by German interests in Hamburg and was to have been the eventual purchaser of the I.G.A. store property in Forest, to be held in the interim by Reginald A. Palmer had that transaction been completed. Commodore Sales Acceptance was repaid its loan with interest, covered by rentals paid to Gregory by Foodway Distributors. Marron & Keon, who had acted both on the purchase and sale of the property by Gregory, reduced their fees by \$250, since "there was very little duplication in the work done,"²⁰ but were apparently induced to reduce them still further by Gregory who wrote on March 2,²¹ "I appreciate the arrangement which we made over the telephone that you would allow me half fees on an agency basis because of my professional status as a solicitor".

These two transactions were analysed by Mr. Walker as follows:²²

TRANSACTIONS INVOLVING I.G.A. STORES AT OWEN SOUND AND
WEST LORNE, BY W. P. GREGORY,
W. A. PIKE, R. E. HART AND R. A. PALMER

1. Owen Sound (purchased by W. P. Gregory)

(a) *Summary of Financial Transactions*

August 3, 1961	Deposit paid to S. Kazman (solicitor for the Vendor) by W. A. Pike, upon receipt of funds from W. P. Gregory.....	\$ 2,000.00
November 30, 1961	Balance of purchase price, provided by Commodore Sales Acceptance Ltd.....	131,000.00
	Cost (A).....	<u>\$133,000.00</u>

¹⁵Exhibit 4394.2.

¹⁶Exhibit 4386.

¹⁷Exhibit 4399.

¹⁸Exhibit 4397.

¹⁹Exhibit 4393.

²⁰Exhibit 4394.4.

²¹Exhibit 4394.5.

²²Exhibit 4411.

November 17, 1961	Deposit received by British Mortgage & Trust Company from Holmested, Sutton, Hill & Kemp re sale of property (this amount paid to W. P. Gregory on March 23, 1962).....	\$ 5,000.00
February 15, 1961	Balance of sale proceeds paid to Atlantic Acceptance Corporation Ltd. from which loan (\$131,000.00) and interest (\$394.15) were paid.....	134,511.14
	<i>Proceeds of sale</i> (B).....	<u>\$139,511.14</u>
	Surplus (B less A).....	\$ 6,511.14
	Rents received	
	December 1961 (Note 1 below) \$ 1,054.17	
	January 1962 (Note 2 below) 1,052.92	
	February 1962 (Note 2 below) <u>1,052.92</u>	3,160.01
		<u>9,671.15</u>
	<i>Deduct</i>	
	Interest paid (by endorsing over cheques for January and February rent to Commodore Sales Acceptance Ltd.).....	2,105.84
	Deducted from sale proceeds by Commodore Sales Acceptance Ltd.....	<u>394.16</u>
		2,500.00
	Legal fees (as to \$1,054.17—by endorsing December rent cheque of Marron & Keon; the balance by W. P. Gregory's personal cheque) <u>1,189.02</u>	<u>3,689.02</u>
	<i>Net Surplus</i>	<u>\$ 5,982.13</u>

Note 1 The rent for December 1961 was paid by S. Kazman to Marron & Keon, who issued their Trust Account cheque under date of December 6th, 1961. W. P. Gregory endorsed this cheque back to Marron & Keon in part settlement of that firm's fees and disbursements.

Note 2 The rents for January and February 1962 were paid by Foodway Distributors Limited to W. P. Gregory, and both cheques (each for \$1,052.92) were endorsed over to Commodore Sales Acceptance Ltd. by Gregory in payment of interest on the loan of \$131,000.

(b) *Receipt of proceeds by W. P. Gregory*

March 23, 1962	Deposit received from British Mortgage & Trust Company (deposited to Account #10330, British Mortgage & Trust Company).....	\$ 5,000.00
February 20, 1962	Balance of net proceeds received from Commodore Sales Acceptance Ltd. (deposited to Account #10330).....	3,116.98
		<u>8,116.98</u>
March 2, 1962	<i>Deduct</i> Legal fees paid by W. P. Gregory to Marron & Keon (paid from Account #10330).....	134.85
		<u>7,982.13</u>
	<i>Deduct</i> Initial investment by W. P. Gregory.	<u>2,000.00</u>
	<i>Net surplus</i>	<u>\$ 5,982.13</u>

BRITISH MORTGAGE & TRUST

2. West Lorne (purchased by W. A. Pike)

(a) Summary of Financial Transactions

November 22, 1961	Deposit paid to W. W. Evans & Sons by W. A. Pike.....	\$ 1,000.00
March 30, 1962	Amount paid to Anderson, Neilson, Ehgoetz, Bell, Dilks and Misener by W. P. Gregory from Account #10330 (treated as loan by Gregory to Pike).....	10,000.00
April 9, 1962	Mortgage provided by British Mortgage & Trust Company.....	35,000.00
		<u>46,000.00</u>
	Deduct Adjustment for taxes upon closing..	68.91
	Cost (A).....	<u>\$ 45,931.09</u>
May 25, 1962	Mortgage assumed by British Mortgage & Trust Company as Trustee for the purchaser	\$ 35,000.00
May 30, 1962	Balance of sale price..... \$17,000.00	
	Deduct	
	Adjustments upon settlement.....	\$238.05
	Fees and disbursements.....	339.33
		<u>577.38</u>
		16,422.62
	Proceeds of sale (B).....	<u>\$ 51,422.62</u>
	Surplus (B less A).....	\$ 5,491.53
	Rents received	
	April 1962.....	390.00
	May 1962.....	390.00
		<u>780.00</u>
		6,271.53
	Deduct	
	Interest paid to British Mortgage & Trust Company on May 25, 1962 from Account #24427.....	305.89
	Net Surplus.....	5,965.64
	Deduct unexplained difference.....	30.26
	Surplus as distributed by W. A. Pike.....	<u>\$ 5,935.38</u>
	Receipt of proceeds by W. A. Pike	
May 30, 1962	Received from Anderson, Neilson, Ehgoetz, Bell, Dilks and Misener (\$16,422.62 plus \$68.91).....	\$ 16,491.53
	Rents received by W. A. Pike.....	780.00
		<u>17,271.53</u>
May 25, 1962	Deduct Interest paid to British Mortgage & Trust Company.....	305.89
		16,965.64
	Deduct Amount borrowed by W. A. Pike from W. P. Gregory.....	11,000.00
	Net Surplus.....	<u>\$ 5,965.64</u>
3. Division of Proceeds		
	Surplus on	
	Owen Sound (W. P. Gregory)*.....	\$ 7,982.13
	West Lorne (W. A. Pike).....	5,935.38
		<u>\$ 13,917.51</u>
	Divisible as follows	
	W. P. Gregory.....	\$ 3,479.38
	R. E. Hart.....	3,479.38
	R. A. Palmer.....	3,479.38
	W. A. Pike.....	3,479.37
		<u>\$ 13,917.51</u>

Distributions

i) R. A. Palmer.....	\$ 3,479.38
ii) R. E. Hart.....	3,479.38
iii) W. P. Gregory	
Advances by Gregory to Pike.....	\$11,000.00
Less surplus on Owen Sound property received directly by Gregory.....	<u>7,982.13</u>
	3,017.87
Share of surplus.....	<u>3,479.38</u>
	6,497.25
	<u>\$ 13,456.01</u>

*This amount is \$2,000.00 in excess of the net surplus shown in Section 1 of this schedule; this is because the initial investment by W. P. Gregory was not excluded from the sale proceeds when calculating the divisible surplus.

On the supposition that a cheque dated July 14, 1961 for \$1,000, drawn by Pike in favour of Gregory, represented payment of one-half of the \$2,000 deposit paid by Gregory on July 17, relating to the purchase of the Owen Sound property, and that Palmer and Hart did not in some manner reimburse Pike and Gregory for their share of the deposit, the calculation of the net profit of Gregory and Pike looks like this:²³

W. P. Gregory profit

Received from W. A. Pike, 17 July, 1961.....	\$ 1,000.00
Net proceeds Owen Sound per schedule.....	5,982.13
Cheque from W. A. Pike, 31 May, 1962.....	<u>6,497.25</u>
	13,479.38
Less paid to Anderson, Neilson re West Lorne.....	\$10,000.00
Less paid to W. A. Pike, 30 March, 1962.....	<u>1,000.00</u>
	11,000.00
	<u>11,000.00</u>
Net.....	<u><u>2,479.38</u></u>

W. A. Pike profit

Received from Anderson, Neilson re West Lorne.....	16,491.53
Received rents.....	<u>780.00</u>
	17,271.53
Less paid interest to B.M. & T.....	305.89
Less paid W. P. Gregory, 14 July, 1961.....	1,000.00
Less paid R. Palmer, 30 May, 1962.....	3,479.38
Less paid R. Hart, 30 May, 1962.....	3,479.38
Less paid W. P. Gregory, 30 May, 1962.....	6,497.25
Less unexplained difference in calculation.....	<u>30.26</u>
	14,792.16
	<u>14,792.16</u>
Net.....	<u><u>\$ 2,479.37</u></u>

If Palmer and Hart did pay their share—and, although documentation of such payment has not been discovered, it seems likely—the net profit of Gregory and Pike would be approximately \$3,000 each.

Wilfrid Gregory was, of course, examined searchingly and at length about the West Lorne transaction. The startling and unpalatable evidence given to the Commission by Mr. Walker on April 12, 1967, and

²³Exhibit 4413.

the part played in it by Gregory and Pike as officers of British Mortgage & Trust Company were widely reported in the press. Counsel did not advert to the subject until the second day of Gregory's examination on April 27, having already discussed the nature of the questions he proposed to put in this matter, as in others, some days before with the witness. The facts known to the Commission were put to him and the questions and answers which followed must be quoted at length, except for some irrelevant digressions.²⁴

"Q. Mr. Gregory, I think I showed you these documents a few days ago. I will describe this transaction, and then if you wish we can go over the documents. There is evidence before the Commission to the effect that on the 22nd of November, 1961, Mr. Pike agreed to purchase a store, subject to the completion of the building, and a certain lease, and this is called an I.G.A. Store in West Lorne for the sum of \$46,000, and there was evidence that a mortgage on that store was granted by British Mortgage for the sum of \$35,000 and that the purchase price was paid in cash as to the balance, out of Mr. Pike's thousand dollar deposit, and the payment of \$10,000 by you to the solicitors. Now, stopping there, did the transaction happen in that manner, so far as I have described it to date?

A. Well, do you want the background?

Q. Yes, please, anything you wish to say. Perhaps if you would like to describe the whole transaction?

A. Well, at this time—previous to this time we had taken some mortgages from the—based on I.G.A. leases (and I don't know who the owners are), but at any rate based on their leases—and we were after some more—and Mr. Pike, I think was going through some intermediary or agent and was told that there may be three or four more I.G.A. stores to go up, but that—and they wondered if we wanted to buy them. We could not buy I.G.A. stores because their company was not yet qualified, as distinct from A & P which were. So, Pike came to me with the suggestion, why don't we form a group to buy the shares, so that British Mortgage can get the mortgages on them that way, and then sell the stores subject to the mortgage, and then we have our mortgages.

Q. Yes?

A. And I said, 'Well, we could try that'. So, there were four of us who got together and we each agreed to take one store in our own name and we would be responsible for that transaction.

Q. Were you in partnership as to 25% each, in respect of the four stores?

A. This was the effect, it was not a partnership, the way we did it.

²⁴Evidence Volume 116, pp. 15816-8.

Q. One agreed to hold in trust whatever profits resulted from the transaction for the others?

A. In equal shares.

Q. In equal shares?

A. Yes."

There then followed an interruption by myself, which was largely repetitious, and the examination continued.²⁵

"MR. SHEPHERD: You were saying that there were four persons, each of whom was going to share equally in the ultimate profit of the sale of the stores.

A. Yes, if there was one. So that Bill Pike had the West Lorne store, which was a small one and came along first.

Q. Let us deal with that one. What occurred in respect to that one?

A. Well, he instructed solicitors and bought the store, and as you have mentioned, he did not have enough money. I loaned him some money. A couple of the other chaps each put up one thousand dollars. We put up four thousand dollars in cash, one thousand each, and borrowed—

Q. Is that in connection with all the stores, the \$4,000?

A. Well yes, but they were coming one after the other, so that we could apply it on the first one, and I loaned Bill Pike \$10,000, in the first place, so that he could handle it, and then he borrowed \$35,000 from the company, because this was to remain on the store, and—

Q. Did the directors know that they were lending to him on that particular loan?

A. Yes, it was very important, and one they were most concerned with was the security of the lease, and the fact that he—well, he said that he was going—that it was going to be sold, the fact that he owned it temporarily was known, it was just an expedient.

Q. When the mortgage loan was approved, did the directors know you had an interest in this store to the extent that you have described?

A. No, I did not mention any of the background of financing to the thing, he was the registered owner, and he was—the fact that he was going to share in profits was not mentioned.

Q. Go ahead, please?

A. So, he went ahead, and then the store, for a period of time was becoming built, was becoming finished, was becoming completed to the satisfaction of the leasee, and then we had to consider about selling it. And this was a darn good investment, because we were figuring on selling it, to yield somebody about 9%, and I thought—I guess I saw Oliver Gaffney at the Rotary Club and I said, 'Oliver, if you are interested in a good store, or lease to I.G.A., for your pension fund, you might talk to Bill Pike, because he owns one'.

²⁵Evidence Volume 116, pp. 15819-28.

Q. Yes?

A. And so after that he apparently talked to him at some lengths, and decided that he would indeed like to have this store, and he was an experienced construction man, and knew values and knew what he was doing. He was about my age, and he actually got Bill down a little in the price he wanted and then finally settled at \$52,000 and there was a letter of instruction from him to the company to proceed to purchase this for the pension fund, and I think—

Q. Perhaps you would like to see that letter, Mr. Gregory?

A. Well, I read it the other day, sir.”

Counsel then read to the witness the letter from the John Gaffney Construction Company addressed to British Mortgage & Trust Company, to the attention of J. M. Armstrong, Q.C., which has already been quoted above,²⁶ and resumed:

“Q. And then, did the British Mortgage in its capacity as trustee for the Gaffney Pension Fund in fact purchase the property for \$52,000?

A. They did indeed.

Q. And that resulted in a profit, as I understand it, did it not?

A. Yes, there was some profit to the transaction.

Q. And was the profit divided equally among the four, I will say partners, appreciating that it is not the legal effect of what you described?

A. Yes, it was divided.

Q. Now, at the time of the mortgage application, Exhibit 14—correction—4378, the property itself—I will wait until you have the application before you, and perhaps show you this copy. The valuation on the reverse side reads:

‘VALUATOR’S REPORT:

This property is lots 19 and 20, plan 107, West Lorne on which there is a new I.G.A. food market leased to Foodway Distributors for 20 years at \$4,680. per year. The land is 132’ x 132’. The lease is guaranteed by M. Loeb Limited, and is completely net.

The store is 87’ x 44’ one storey, cement block with glass and vitriolite front.

Estimated value \$52,500.00.’

And, is that signed by you?

A. It is.

Q. Did you consider when valuing this property for the company that you were under any obligation to inform the directors that you had an interest in the nature which you have described?

A. No, I did not.

²⁶Exhibit 4385.

Q. Do you now consider that you were under some obligation?

A. No. I probably would have done it just so somebody would say, 'Why don't you do it', but the point was, it was quite immaterial to the security that we were being asked to take. This was a lease from Loeb, based on a 9% return and valued at 6, which anybody could see was a darn good security, and the kind of loan we wanted, and the directors jumped at it. The fact that Mr. Pike presented it as his own was quite all right. The fact that if he had said two or three other people, including the managing director also had an interest, if we make a profit, it would really not have been material. In fact—well, it would not have affected the transaction whatever. Now, I will go—so far as what you said before, out of what I have been through, I certainly would not get myself in a position where anybody could point a finger at me. This is the unfortunate thing about it. I was completely honest and got them a darned good loan and got Gaffney a wonderful investment at 9% that they are delighted with and yet I suffer.

Q. I want to see now if I understand your position properly. Did you take the view that the transaction being an effective one, from the viewpoint of the company, in that the mortgage was a reasonable one, it was not material or necessary for you to disclose to the directors your interest, nor was it necessary for you to disclose to them your interest when you were—you were the person valuing the property? Have I put it fairly?

A. You have put it fairly, sir.

Q. Let us turn to the position of the Gaffney Pension Fund. Did you consider that you were under any obligation to disclose to Mr. Gaffney the fact that you had an interest in this property?

A. No, because he was—and if maybe I had known Bill Pike was, I would not have objected the slightest, but when he had not done it, I did not feel I had to seek him out and tell him that because he knew he was dealing with the owner. He was on his guard, and to say that somebody—that the owner really only had one-quarter of it, and somebody else, including myself, had a quarter, I still don't see where it enters into it, as far as affecting the judgment of Mr. Gaffney.

Q. Now, that purchase had to be ratified, and was ratified by British Mortgage and Trust in its capacity as trustee. Do you say that upon the same ground as you have set out you were under no obligation to disclose to your directors at British Mortgage and Trust that you had an interest in this property being sold to it in its capacity as trustee?

A. That is right.

Q. Is there anything else you wish to comment on this matter?

A. No, you have covered it fully. The results were good all round, we did not make much money, but as the Commissioner said, 'well, you probably would not do it again', and I agreed."

It remains to be seen what J. R. Anderson, Q.C., head of the firm which acted in the West Lorne transaction, and J. M. Armstrong, Q.C., assistant general manager and head of the trust department of British Mortgage & Trust Company, knew about the participation of the company's president and its mortgage manager. Anderson said that the matter was handled entirely by his partner Bell, but that it was eventually drawn to his attention in discussion of the problem presented by mechanics' liens, and he continued:²⁷

"Now, at or about that time, Mr. Bell, who called to my attention, or spoke to me of the fact that this property was being conveyed to the Gaffney Pension Trust from William Pike, an employee. And we both agreed that looked strange. This was really the first I knew of that. And I suggested since he had the file and the conduct of the matter and knew the whole file, he should speak to Mr. Armstrong, the assistant general manager and head of the trust department and, of course, Mr. Pike's superior officer, too, in the company. Which Mr. Bell subsequently reported to me that he did.

And I can't be clear whether it was one or more conversations Mr. Bell had with Mr. Armstrong, but there are two things I specifically remember. First of all, an angry reaction by Mr. Armstrong, and he was certainly going to look right into this. And the second thing was subsequently, while this is all right, this deal is all right, Gaffney has been fully informed about it, and it is all right, there are not going to be any more of these.

Q. That is, Gaffney had been informed of Mr. Pike's interest, because that was the only interest Mr. Armstrong knew of?

A. And we knew of, as we had no arrangements, as much as I know of this. If Mr. W. P. Gregory had any interest in the transaction none of us knew anything of that until away after the collapse.

Q. Can you assist us as to whether the fact that the purchase price—the closing payment of \$10,000 required to be paid by Pike was paid into your firm by a cheque from Mr. Gregory, whether that would come to your attention, or did come to your attention?

A. It didn't come to my attention and would not. And I would add in that connection, I looked at the ledger card at our firm just the other day, and found that all this is entered, including that cheque, in the handwriting of one of our secretaries, our bookkeeper, actually.

Q. Could you explain, so it would appear on the record, how cheques would come in from persons dealing with the firm to be credited to the trust account, and the solicitor on the matter not know the origin of the moneys?

A. Well, the solicitor will tell his client, the purchaser, that he now needs so much money to close the deal.

²⁷Evidence Volume 117, pp. 16013-6.

Q. Yes?

A. The purchaser will either bring in the cheque or send it in. The solicitor may not even be in the office. It will come in probably to the firm, and there is a ledger card for that client.

Q. Yes?

A. And the secretary of the solicitor involved, or the bookkeeper, will put it in the trust account, see that it is certified, if it has not been certified, and advise the solicitor, 'We are now in funds.'

Q. Yes. Have you satisfied yourself by inquiry from Mr. Bell, that neither was he aware that the source of the money for the Pike purchase was a cheque from Mr. Gregory—

A. That is right.

Q. —and all he knew was that Mr. Pike put the firm in funds and you were in a position to be able to close?

A. That is right. . . ."

After an intervention by me to clarify the position of the Anderson firm as general solicitors of the company, in the course of which the witness said that they were general solicitors, but had no retainer and handled only some 5% of all the legal business of the trust company, counsel continued the examination.²⁸

"MR. SHEPHERD: Do you recall the meeting at which the mortgage loan to Mr. Pike was approved, a \$35,000 loan?

A. No, I really don't. I don't recall. I cannot summon to my recollection any discussion of that. I have no doubt it was approved. Whether his name was mentioned in connection with it, though, is something I don't just know about.

Q. Would you agree with me it would be probable that you or members of your firm would have the impression that it was approved because you acted for the company in respect of that mortgage and would therefore know at that time that Pike was the registered owner of the property?

A. Well, my partner, Mr. Bell, would know. I really just wasn't aware of it, along in there.

Q. May I take it in your judgment Mr. Bell would simply assume that British Mortgage had approved the mortgage and would deal with Pike's interest?

A. Yes, I would say so.

Q. Do you have any recollection of Mr. Gregory, who, as appears by the evidence before this Commission, and who indeed stated in his evidence was the person who valued this property for British Mortgage, do you have any recollection of the executive committee knowing when they accepted the valuation that he had an interest in the property?

²⁸ Evidence Volume 117, pp. 16036-7.

A. No, I have no such recollection and I am quite certain that I did not know, and I was on the executive committee, and I did not know at any time that he had an interest in the property.”

Evidence as to the “angry reaction by Mr. Armstrong” was given by Armstrong himself on the same day.²⁹

“Q. Would you begin with what you first recall of the incident, what you know about it?

A. It came to my attention that Mr. Pike had sold the property to the Gaffney Pension Trust.

Q. Do you remember how you learned that?

A. I am not sure, I thought—I have been trying to recall. It may have been either from a notice in one of the meetings of the realization of assets in the Pension Trust in order to provide funds for the purchase of this asset, or the Anderson firm may have—one of the members of the Anderson firm may have spoken to me about it. I don’t know. But I know it came to my attention after the act, after the transaction—

Q. Had been agreed to?

A. Agreed upon, yes.

Q. What was your reaction to that?

A. I was shocked, extremely angry.

Q. And what did you do?

A. I immediately went to Mr. W. P. Gregory. I spoke to him and told him that I was shocked and amazed that this had been done, and I wanted a full and complete—I asked him if a full and complete disclosure had been made to Mr. Gaffney. And I wanted a complete report from Mr. Pike so that I could be satisfied that Mr. Gaffney knew what was involved, and that he would have the right to, after receiving that information, to either repudiate or confirm the transaction. And that I was amazed that anything like that could transpire in our organization.

Q. What did Mr. Gregory say?

A. Mr. Gregory said, ‘Go ahead’. He intimated to me that Mr. Gaffney knew that Mr. Pike—of Mr. Pike’s interest. But, I nevertheless insisted I wanted a report, and I was going to get in touch with Mr. Gaffney personally.

Q. Do I understand you had a rule, a well understood rule in the trust department affecting transactions such as this?

A. Well, it had always been my belief, sir, and the principle which I have always followed, and have tried to instill in any of my—in persons working for me in a trust capacity, that there must not be any conflict of interest whatsoever, that their prime responsibility as a trustee is to administer the trust in any sense of the law for the sole benefit of the cestui que trust, there must not be any conflict of interest. Furthermore, there should not even be a suspicion of conflict of interest.

²⁹Evidence Volume 117, pp. 16089-93.

Q. In your conversation with Mr. Gregory did you find it necessary to specifically state this, or did you simply take it to be understood?

A. He knew this because I had on many occasions enunciated this principle to the persons who were brought into the trust department, and to each of our managers and the assistant managers in trust seminars we were holding over a period of time. He knew my views on this. There is no question about that, sir.

Q. Do I take it Mr. Gregory said something to the effect he believed Mr. Gaffney to know of Mr. Pike's interest, and he was not interested, you could get a complete report on the matter from Mr. Pike?

A. Oh, yes.

Q. Then, what did you do—I am sorry, did Mr. Gregory say anything else, or is that the end of that conversation?

A. I said—my recollection is that I said that I hoped there never will be anything similar. And he told me to go ahead—I am trying to recall his exact words. I think it was: 'Go right ahead, Monty, and rest assured there will be nothing similar'.

Q. And what did you do then?

A. I immediately got in touch with Mr. Pike and told him I wanted a complete report, not only of the transaction, but of the background. I wanted to know the price that was paid, the price that it was being sold at, the profit, so forth, complete particulars, and I wanted it in writing.

Q. And did he agree to supply them?

A. He did, sir.

Q. Did he supply you with a written report?

A. Yes, sir.

Q. Have you since that time caused a search to be made of the Gaffney Pension Trust file in an endeavour to find a copy of that written report?

A. I have, sir.

Q. With what result?

A. No result, sir.

Q. Then, you received the report from Mr. Pike. And generally what was that report, so far as you can recall without having it before you?

A. My recollection of the report was the price which he paid, the price at which it was being sold, the lease, the particulars of the lease, the operating costs of the property and the net yield.

Q. And receiving that information what did you do then?

A. I immediately got in touch with Mr. Gaffney, and then subsequently wrote him.

Q. What did Mr. Gaffney say of his knowledge of the matter when you talked to him?

A. I can't recall my telephone conversation with him, but he confirmed the transaction and was willing that it be retained in the Pension Trust.

Q. Yes. Then, did you write Mr. Gaffney a letter as well?

A. I wrote Mr. Gaffney, yes, sir. Either I wrote a letter or caused a letter to be written, I am not sure."

The letter which Armstrong wrote to Gaffney was dated May 7, 1962, was addressed "Dear Oliver",³⁰ and read as follows:

"In accordance with our telephone conversation today, I enclose a draft letter for your consideration. If this form of a letter meets with your approval, it would be appreciated if you would have it completed and returned to us in due course in lieu of your former letter of instruction dated May 1st 1962."

The draft letter which accompanied this communication was the one dated May 1, 1962, already quoted on page 1172 except for three words, of no relevance to this account, excised by Gaffney. Armstrong's letter of May 7 and the draft which he sent, copies of which were supplied to the Commission and certified by Victoria and Grey Trust, were then introduced into evidence and the examination proceeded.³¹

"Q. . . . I take it from the internal evidence in that correspondence, Mr. Armstrong, what happened was you obtained the necessary information from Mr. Pike, you informed Mr. Gaffney orally, and he must have written you a letter. And you prepared, then, a letter, a copy of which we now have, setting out in the clearest terms that he knows that Pike, the mortgage manager, is the vendor of that property. You sent that to him and asked him to sign a letter in those terms and return it, which he did?

A. Yes, sir.

Q. And was that the end of that transaction so far as you can assist us?

A. Yes, except that I was always concerned that that property should be sold from the Pension Trust, and as soon as it possibly could be done so, without cost to the trust.

Q. Yes. I take it from what you have already said, Mr. Armstrong, that it is quite clear that at no time prior to this Commission sitting, were you informed by anyone of any interest direct or indirect of Mr. W. P. Gregory in that transaction?

A. I had no knowledge of it whatsoever, sir."

From this evidence, which I accept, it is clear that Armstrong, also, had no knowledge of the actual amount which Pike had paid for the West Lorne property.

The explanation of his actions and motives contained in Wilfrid Gregory's evidence by no means removed the painful impression which

³⁰Exhibit 4627.

³¹Evidence Volume 117, pp. 16095-6.

the disclosure of his part in the West Lorne transaction had produced. In a matter affecting one of its benchers the Law Society of Upper Canada moved with understandable deliberation. Counsel was retained and examined the proceedings of the Commission and the relevant exhibits, copies of which were provided. Charges were in due course preferred against Gregory and heard on February 9 and 10, 1968; by letter dated February 2 he had at last tendered his resignation as a bencher which was accepted by Convocation on February 16. The Discipline Committee of the Law Society subsequently presented its report to Convocation in the following terms:

“IN THE MATTER OF THE LAW SOCIETY ACT AND IN THE MATTER
OF WILFRID PALMER GREGORY OF THE CITY OF
STRATFORD, A BARRISTER AND SOLICITOR.

A Notice of Complaint was served upon the solicitor, dated the 12th of January 1968 and returnable before your Committee on Friday the 9th of February 1968 at 10.30 a.m. It contained the following specific complaint:

“TAKE NOTICE that it is alleged that you have been guilty of conduct unbecoming a Barrister and Solicitor in that,

At a time when you were the beneficial owner of a one-quarter interest in certain property at West Lorne, Ontario, and also a director and member of the executive committee of British Mortgage and Trust Company,

- (a) You did between March 28th, 1962, and May 1st, 1962, personally participate in the corporate procedures of the said trust company whereby it approved a first mortgage loan to the nominal purchaser of the said property, namely, William Pike, in the amount of \$35,000 without disclosing your personal interest therein to the Directors of the said trust company.
- (b) You did on or about March 26th 1962, in furtherance of the above referred to application to British Mortgage and Trust Company for a mortgage loan, submit a written valuation of the aforementioned property under your signature for presentation to the executive committee of the said trust company as evidence of the true value thereof without disclosing your personal interest in the said property to the other members of the executive committee.
- (c) You did personally promote the sale of the aforementioned property to the Trustee of the Pension Fund of John Gaffney Construction Company Limited, namely, British Mortgage and Trust Company, by recommending the purchase thereof to John Gaffney, an officer of the said company, well knowing that the purchase price would result in a personal profit to yourself as well as to your associates, without disclosing to the said John Gaffney your proprietary interest in the said property.

- (d) You did as between May 1st, 1962, and May 29th, 1962, personally participate in the corporate procedures of the said trust company whereby in its capacity as Trustee of the Pension Fund of John Gaffney Construction Company Limited, it did approve the purchase of the said property at West Lorne for the said Fund without disclosing your personal interest in the said property to the Directors of the said trust company, and further without disclosing to them that you stood to profit personally by such sale and that you subsequently did so profit as a result of such sale.

Your Committee met at the appointed time and was composed of the following members: Mr. W. Gibson Gray, Chairman, in the Chair, Mr. Gordon Ford, Vice-Chairman, and Messrs. Bowlby, Bull, Chappell, Dubin, H. E. Harris, Levinter, Pepper, Robins, Strauss and P. D. Wilson. Mr. W. J. Smith, Q.C., attended for the Society and the solicitor attended with his counsel, Mr. J. T. Weir, Q.C., and Mr. G. J. Smith.

Upon the evidence before it, your Committee finds the specific complaint to be established.

With respect to the specific complaint, the solicitor held a fiduciary position as Managing Director of British Mortgage and Trust Company and actively participated in the investment of the Company's trust funds. He was under a clear legal and moral obligation to disclose his personal interest in the West Lorne property to both the Trust Company and the Pension Fund. In not having done so the solicitor failed to maintain the standard of ethics and integrity expected of members of the Law Society. The solicitor's conduct in all the circumstances of this case was, in the judgment of the Committee, contrary to the best interests of the public and the legal profession and constitutes conduct unbecoming a Barrister and Solicitor. Your Committee recommends that the solicitor be reprimanded in Convocation and that the fact of his reprimand be published.

Wilfrid Palmer Gregory was called to the Bar and admitted as a solicitor of the Supreme Court of Ontario on the 18th of June 1936.

All of which is respectfully submitted.

Dated the 8th day of April 1968.

'W. GIBSON GRAY'
Chairman"

Gregory was reprimanded in Convocation by the Treasurer of the Society, and the proceedings were duly published in the law reports.³²

Yonge-Eglinton Building Limited

Unfortunately the catalogue of irregularities was not complete. The Commission's accountants examined the affairs of two companies called Promenade-Swiss Corporation Limited and Yonge-Eglinton Building Limited. All of the shares of both companies were originally owned,

³²(1968) 2 O.R. p. cxxi.

legally or beneficially, by Gerhard W. Moog. Promenade-Swiss, in partnership with P. J. Colbourne Construction Limited, had been a successful applicant for a mortgage from British Mortgage & Trust to secure advances of \$285,000, approved by the trust company's executive committee on November 3, 1959. This mortgage was taken to finance a sub-division development in Brampton, Ontario. On January 13, 1960, Anita Moog transferred to W. P. Gregory one common share registered in her name and, at a directors' meeting held on January 15, 1960,¹ Gregory was elected vice-president, and Gerhard Moog transferred to him 99 of the 326 issued common shares which he had hitherto held himself. At a later directors' meeting, held on April 3, 1961, a transfer of these shares from Gregory back to Moog was authorized, and Gregory's remaining share was subsequently transferred to a solicitor in the firm of Campbell, Godfrey & Lewtas on September 19, 1963; in the interim, on July 25, 1962, Gregory had resigned as a director and officer of the company.² No payment was made for the 100 shares by Gregory when received, and none received by him when they were given back to Moog. However, as consideration for surrendering his shares in Promenade-Swiss, Gregory received 25 of the 100 issued shares of Yonge-Eglinton Building Limited on April 14, 1961.³ The board of directors of this company on May 1, 1961 resolved to borrow the sum of \$200,000 from British Mortgage & Trust Company, to be secured by a first mortgage on properties situated in an area bounded by Yonge Street, Eglinton Avenue and Berwick Avenue in Toronto, to finance preliminary construction of a large office building over the Toronto Transit Commission's subway station at 2200 Yonge Street. A curious feature of this transaction is that the files of British Mortgage & Trust contain an application for a loan of \$600,000 for temporary financing, dated February 21, 1961 and approved on February 28 by the executive committee, five members of which initialled the back of the application, including W. P. Gregory. There is no reference to this application⁴ in the minutes of directors' meetings of Yonge-Eglinton Building⁵ which had been incorporated on December 20, 1960. The interest rate for \$600,000 was fixed at 10%, but a note at the foot of the application reads. "provision to be made for interest to be calculated at 8% only for the \$200,000 of this loan"; thus it may be presumed that the mortgagor only contemplated drawing \$200,000 of the total amount secured by the mortgage. By resolution of the board of directors dated May 15, 1961 W. P. Gregory was elected a director of the company and appointed vice-president. In August of the same year Gregory joined with Moog to guarantee a loan to Yonge-Eglinton Building of \$800,000 from the Toronto-Dominion

¹Exhibit 4606.

²Exhibit 4607.

³Exhibit 4610.

⁴Exhibit 4615.1.

⁵Exhibit 4610.

Bank. By this time the Manufacturers Life Insurance Company had committed itself to long-term financing of \$5,250,000. A memorandum accompanying the application for credit in the bank's file contains the following paragraph with reference to the guarantee:

"Mr. W. P. Gregory, who is Managing Director of British Mortgage and Trust Company, will have a 25% interest in the building and we are stipulating his guarantee in our security. Mr. Moog said he had discussed the matter of personal covenants with Mr. Gregory, who apparently feels the project is amply financed and should stand on its own. We have no idea what his worth might be, but are inclined to believe he is reluctant to guarantee because of his position. He has told Moog that if we are not prepared to provide assistance, he is sure the Bank of Montreal, who have the account of British Mortgage and Trust, would accommodate them. For our part, we would insist on his guarantee for whatever it may be worth."

In subsequent internal correspondence between officers of the Toronto-Dominion Bank there is constant repetition of Moog's complaint that Gregory's participation had been of little use to the 2200 Yonge Street project and of his desire to get back his shares, even to the extent of paying \$25,000 or \$30,000 for them, which the bank's officers advised him might be necessary.⁶ Finally Gregory, in a handwritten document addressed to Harry Winton Investments Limited, granted this company an option until May 17, 1962 to purchase his shares for \$10,000 and the release of his guarantee to the Toronto-Dominion Bank, and the shares were duly given up. The loan by British Mortgage of \$200,000 was repaid on July 19, 1962.

The facts of this transaction were succinctly put to Wilfrid Gregory by counsel and he explained his part at considerable length.⁷

"A. I would be glad to go into that, sir. Mr. Moog—I guess we met in connection with this mortgage transaction in 1959, and he came to me and asked me if I would be a director of this company, Promenade Swiss, and I came down to see him and we discussed it and he said he needed to have somebody who knew more about the mortgage business, and somebody who had a little more prestige, if you will, to deal with people, and that he had an agreement to get a lease from Loblaw's—he had been negotiating with the T.T.C., and so on, in connection with a building at 2200 Yonge Street, which is the building at the corner of Yonge and Eglinton, which is now there, and he asked my assistance. I said, 'What are you prepared to pay me to be a director of your company?', and he said, 'Well, I have not got any money, and it is not the sort of thing I want to pay for, but how would 10 per cent interest in it be for your remuneration?', and, I said, 'That would be satisfactory', and so from that time on, almost two and a half years I guess, I spent

⁶Exhibit 4614.

⁷Evidence Volume 116, pp. 15893-9.

a great deal of the time in which I was in Toronto working with Mr. Moog.

Now, first of all, we started off to get the Loblaw lease finalized, and I went to see Mr. Meech, and some of the other people at least twice. After we finally got that settled we had to go to work on the T.T.C. officials, and I think there were a couple of conferences there. We got that settled. I went to see Mr. Davies, whom I knew, of Manufacturers Life, and negotiated a \$7 million loan on this building to be built, and finally, by the time we came around to where we were going to form the new company, Yonge Eglinton, to build the building, or to hold the lease, it was not a grant, I gave up the interest in Promenade Swiss, which had some interest in the Colborne Properties in Brampton. There was some equity there, and because of the work I had done—because of my agreement to go on a guarantee with Toronto-Dominion Bank for some hundreds of thousands of dollars, we agreed that a 25 per cent interest in this new company, which is nothing more than an idea at the time, would be reasonable compensation. So, from that time on we continued to negotiate for him. We went—I worked with him on tenancies. I can remember some of them—well, first of all came the Foundation Company, who were going to build the building, and there was considerable discussion, and finally a contract settlement with them of 7 or 8 million or a 10 million dollar contract.

And then came the question of leases, and there was General Foods—we approached—yes, I think General Foods finally went in. We approached Procter Gamble, who were not interested and Crane, I knew some people, because they were in Stratford, and I got in touch with them, and they were not interested, and there were quite a number—quite a bit of work there, and I must say I was down in Toronto three days a month for Benchers' meetings, which took part of three days and the rest of those days, and lunch time and nights, I would be with Jerry Moog, and he would be able to make appointments for me to do these things. But, it finally got to be just too much, and he was making more and more demands on me, which I was not surprised at, because the leasing was not going as well as we had hoped for a while, and he wanted my help, and I got concerned about the Toronto-Dominion Bank guarantee because it was a personal guarantee, and I had a lot more at stake than he did. So finally I said, 'Well, if you could find somebody to buy out my interest, I would be glad to get out, and we will leave it to you', and I thought I was very generous with him, which I think you will agree. He brought his accountant down and we got together one night to discuss how much he should pay me, and I happened to know that he had told his bank manager what the share was worth—it was some times the figure that I asked for—which I asked for, which I asked for, which was \$10,000, which was I thought a nominal sum, and this was settled, and since then we have done no more business for him, unfortunately, as he is a very able active developer, but we went into this thing in order to try to get loans. This is one reason at the time I was very interested in getting involved in

some of these things. You might think I did not prosper but it was the only way to get them, and when it came time for him—he had two or three other loans with us besides this one, but when it came time to build the Eglinton Tower, the Yonge Eglinton Tower, he needed a couple of hundred thousand dollars to clear some leased property, and as a temporary loan, until he could get his first draw, and he needed \$200,000, and I had to negotiate this with Mr. Facey, and the thing came through, and it was approved, it was on the basis of his lease that he had, and some buildings and so on, and we also managed to get two or three other—two or three other favourable conditions in which—such as the right to have our choice of space on the promenade floor, and our name, and so on. And that is the story.

Q. On the occasion of the \$200,000 loan to which you allude, in the evidence before the Commission you were a shareholder of the company, and it does not appear by the minutes of British Mortgage & Trust at least that the directors on approving that loan were aware that you were a shareholder, can you assist us as to whether the directors knew, notwithstanding that it does not appear in the minutes?

A. Well, they knew at the beginning which of course was—was it a year or so before the actual loan—do you know the date of the loan?

Q. Your 25 shares were transferred by Mr. Moog to yourself on the 14th of April, 1961. There was a resolution of the Board of Yonge Eglinton Building Limited empowering the company to borrow the \$200,000 on certain houses on Berwick Avenue, as I recall it?

A. Yes.

Q. On the 1st of May, 1961, which loan did in fact get advanced some time during the month of May?

A. I think it was over a year before that I first went in with Jerry Moog.

Q. That would be in Promenade Swiss?

A. With Promenade Swiss, yes. You think of these companies in terms of people, as you have noticed, and this was Moog, and I went in with him, and mentioned to the directors that I was doing that and they were very pleased, because it looked as if it was an avenue for getting loans.

Now, I do not believe when the time for this actual \$200,000 came through from Facey that I felt obliged to say that I had a certain interest. Again, gentlemen, on this, it did not seem important. The security, as I mentioned before, is what we base loans on, and if I had told the directors that I was interested, then they would be more likely to have looked favourably than otherwise. I wanted them simply to judge this thing on the proposal before them.

Q. Did Facey know you had an interest in the company?

A. I don't think so, no, I wanted him to do the thing in a normal manner, and the mortgage paid off in about a year, and that was it."

Although Gregory was not as difficult to settle with as officers of the Toronto-Dominion Bank seemed to think he might be, and there is a strong possibility that Moog, who had entered into the association with his eyes open, had little to complain about, there is no doubt in my mind that it was not only injudicious but improper for the president of a trust company, which had loaned large sums to Moog's companies, to take a personal position in them and to derive a personal profit from doing so. He made no attempt in his evidence to suggest that he held his shares, his office and his seat on the boards of directors as trustee or nominee for his own company. I cannot accept his statement that the board of directors of British Mortgage & Trust knew of his interest; in fact all those directors examined by the Commission, who were in office at the material time, firmly denied on oath that they had ever heard a declaration of interest by Gregory or any other officer of the company in relation to this or any of the trust company's loans, and I believe them.

The Dale Estate Transaction

The underwriting of the shares of The Dale Estate Limited has already been dealt with at some length in Chapter VIII, dealing with the affairs of Commodore Business Machines, because of the necessity of explaining its relationship to the complicated financial transactions which were undertaken on July 10, 1963.¹ It has been seen that The Dale Estate Limited undertook to acquire the undertaking of Dale Estate Limited, the predecessor company, for a total consideration of \$1,610,000 and that an important element of this consideration was a first mortgage for \$500,000 given to British Mortgage & Trust Company, secured by the horticultural lands and buildings in Brampton which were to be thereby acquired.² An application for the loan, signed on behalf of the new company for Annett & Company Limited by D. R. Annett and C. G. King, was made to British Mortgage & Trust Company on October 26, 1961. The application form³ contained a valuation by L. W. Facey of the lands and buildings in the amount of \$2,000,000 and it was initialled as approved on October 31 by Messrs. W. H. and W. P. Gregory, Baker, Kenner, Manson and Anderson. The old Dale company was paid \$1,460,000 in cash and received 160,000 common shares of the new company valued at \$1 per share. Of these shares 60,000, together with cash, went to Yarrum Investments, a Trio Company, from which Hilltop Holdings, another Trio company, bought 10,000 at a price of \$10,000 on January 19, 1962, the purchase price being paid by a cheque of that date drawn in favour of Solomon & Samuel in trust.⁴ A memorandum in the handwriting of W. L. Walton, dated March 17, 1962, entitled

¹pp. 356-61.

²p. 359.

³Exhibit 4466.

⁴Exhibit 4459.

"Schedule re Cost of Dale Shares",⁵ which has been previously reproduced,⁶ referred to:

"10,000 re W.P.G. @ \$1	=	10,000 — paid by Hilltop
re N.G.K. for		9,500 "

These shares were registered in the name of Carl Solomon in trust on February 16, and then were subsequently divided into two certificates and registered in the name of Gee and Company, nominee for the Canadian Imperial Bank of Commerce. They were used as security for bank loans to Dallas Holdings and, eventually, on December 4, 1964, were registered in the name of Associated Canadian Holdings.⁷ Their history is unimportant except in the early stages of their existence when, according to Walton's note, they were destined for "W.P.G."

As Pike advised Messrs. McCarthy & McCarthy, solicitors for the applicant company and also for British Mortgage & Trust in this transaction, by letter dated October 31, 1961,⁸ the mortgage for \$500,000 was to bear interest at 7¼ % per annum and to be for five years duration. It was to contain provision for payment of the full amount secured at any time, without bonus, on one month's written notice and there was to be no compulsory payment of principal prior to maturity, although it was provided that the trust company would give partial discharges of the mortgage in the case of any parcels which the mortgagor desired to sell, upon payment of an amount not in excess of 50% of the sale price. On November 13, 1961 Pike wrote again to the McCarthy firm saying that "we have had discussions with Mr. Carman G. King of Annett & Co. regarding the terms of the mortgage" and instructing them to change the date of maturity from November 1, 1966 to November 1, 1981, thus extending its life from five to twenty years. He forwarded the trust company's cheque for \$499,500, the net amount of the advance after deduction of its inspection fee, on December 15. The question of this change was put to Wilfrid Gregory, particularly because there is no record in the minutes of British Mortgage & Trust of any authorization of an extension of the term.⁹

"Q. Now, with the assistance of those documents can you help us as to how this loan came to be changed after approval by the board, to a twenty year loan?

A. Well, I suppose that is not very difficult. They wanted a longer loan in order to handle their connections.

Q. Did you have any discussions with anyone about the change?

A. I don't recall. I may have, Mr. Shepherd.

⁵Exhibit 1702.1.

⁶p. 360.

⁷Exhibit 4461.

⁸Exhibit 4626.

⁹Evidence Volume 116, pp. 15794-6.

Q. Are you able to assist us now?

A. I think Mr. Pike would certainly mention it to me.

Q. I would think so, yes.

A. Yes, I would think so.

Q. Would it have been your normal practice on a loan such as this, where the mortgagor has the right to pay in whole or in part without bonus on thirty days notice if you are changing it from five to twenty years. Would you normally return to the board for their approval of a change of that nature?

A. Yes, I think it should be. Just it should be referred back—just to have it noted.

Q. Now, in this particular case subject to something being found which I have overlooked, there would not appear to be any approval of the board for this change.

Can you assist us on this?

A. I haven't looked at the minutes. I really can't assist you.

Q. Mr. Morgan is referred to in Mr. Facey's letter of valuation. Can you help us as to what your understanding was of Mr. Morgan's association with this loan?

A. The Annett and Company were financing—were buying out the Dale estate and were selling to the public and I believe a large part was going to Latchman Federal Farms and another group in which Powell Morgan was involved, was taking some percentage, sort of a block of stock, and then the rest—well, Annett and Company may have been taking some and the rest was being sold.

Q. Did you have a discussion directly with Mr. Morgan about it, or did you get this information from Mr. King?

A. I dealt with this entirely with Mr. King."

Counsel then reviewed the part played in the underwriting by Yarrum Investments Limited and the fact that it had made a profit in the order of \$138,211. He then referred to Walton's handwritten note and the transaction between Yarrum and Hilltop Holdings which resulted in the purchase of 10,000 of Yarrum's 60,000 shares of The Dale Estate Limited, concluding by asking Gregory for his assistance as to what the transaction was about.¹⁰

"A. Well, I can assist you to some extent, sir. As I mentioned, I was asked to participate in this original financing, and . . .

Q. Who asked you, Mr. Gregory?

A. Oh, I am sorry, Mr. King asked if I would like to go in on Dale Estate as he had asked me in a good many things and with a lot I had

¹⁰Evidence Volume 116, pp. 15797-802.

gone in for a minor participation, and I said, 'I would take ten thousand shares at a dollar whenever they were ready to issue them'. This was the preliminary planning on it and that was that. Then, sometime later, I can't recall how long—two or three weeks possibly—he said, 'Well, we would like British Mortgage to lend some money in a mortgage'. I said, 'Well, that is fine.' And I said, 'See Mr. Facey about it', and they carried on that way, and then—I don't think it was at that time—but sometime later, Mr. King and I were discussing it and he said, 'I think we are going to be able to get that mortgage from British Mortgage and I don't think you should be in a position of having shares in Dale Estate', and I agreed and I said, 'What do we do?' and he said, 'Well, you may be able to get Mr. Morgan to buy them. He has a substantial interest'. So I called him and said, 'Do you want my ten'. The right of my ten thousand, my right to buy ten thousand shares of Dale Estate. And he said, 'Fine'. I said, 'What will you give me for it?' and he said, 'Oh, would a \$10,000 note in N.G.K. be all right', because I think this was the right to buy at a dollar and at this time I guess there were, as things were developing—they were worth a little more and then finally put them out to the public at \$3.00. So at any rate, I said, 'Fine.' I took this \$10,000 convertible note in N.G.K. which eventually became worthless of course, but still, that is how I got involved in the thing and my ten thousand, the right to buy ten thousand shares were turned over to Mr. Morgan.

Q. Did you pay for the note issued by N.G.K. Investments Limited in the principal sum of \$10,000?

A. No, I didn't pay for it. He gave—transferred it to me.

Q. It was free in your hands?

A. That is true, yes.

Q. When did you have the discussion with Mr. King approximately, when he suggested that it would be better for you not to hold Dale Estate shares?

A. I think it was when they were beginning to prepare the prospectus and get working on the more definite plans for the financing.

Q. Were you intending to pay for the Dale Estate shares?

A. Well, certainly, yes. I would be quite happy to have been on the deal. I gave up that privilege because of the fact the company could get the mortgage.

Q. Can you assist us as to why Hilltop paid \$10,000 for shares which Mr. Walton records as being 're: W.P.G.'?

A. I knew of nothing after I got the \$10,000 N.G.K. convertible note and said to Mr. King, 'Mr. Morgan has taken over my interest'.

Q. Now, you were buying escrowed shares. Is that correct?

A. I don't know. They were to be shares at any rate that were to come to me as at a dollar.

Q. You were to get 10,000 shares at a dollar. Is that so?

A. That is correct.

Q. The issue price of these shares was . . . ?

A. \$3.00.

Q. \$3.00?

A. Yes.

Q. Can you assist us as to why you were to get 10,000 shares at a dollar, when the shares were being sold at \$3.?

A. Well, of course I didn't know then what the shares were going to be sold at. I don't know whether they did—they were just planning this thing and whenever you plan a thing as you know, they start off at the—a group putting up some money or committing themselves to money, in order to get going and as I say, I had been in this case many times—this situation, many times with Mr. King before and a couple since.

Q. But you said that Mr. King had this discussion with you at the time they were preparing the prospectus?

A. They were about to, somewhere.

Q. Mr. King is a member of Annett, who were the underwriters, is he not?

A. Yes.

Q. He would presumably know that the shares were going to be issued at \$3.00?

A. Well, all I said, Mr. Shepherd, at first, we didn't know. This was some considerable time before the prospectus. At that time, we certainly knew that they were going to be issued at \$3.00, but I think I was out of my interest long before."

Later Gregory was to suggest¹¹ that British Mortgage & Trust obtained a bonus of 10,000 shares. The evidence is in fact, as indicated in the transcript quoted above, that he was persuaded to relinquish the 10,000 shares of The Dale Estate for a convertible promissory note of N.G.K. Investments which, according to the note certificate book of that company,¹² was issued in the form of certificate No. 29 with a face value of \$10,000 to Wilfrid P. Gregory as payee on June 19, 1962. These records were put to the witness who agreed that certificate No. 29 might well be his note and that he had not paid for it. Gregory said that the arrangement with C. P. Morgan for the issue to him of the 10,000 shares was made before the prospectus for The Dale Estate had been issued and before the application by that company for its loan of \$500,000; he got his note when Morgan "got around to it". Counsel pursued the subject,

¹¹p. 1206.

¹²Exhibit 1241.

particularly with reference to the discount Gregory was to obtain by paying \$1 per share for 10,000 shares which were to come on the market at \$3 each.¹³

“Q. You say that you had a right to buy Dale Estate shares at one dollar to the number of ten thousand. Is that correct?

A. That is correct.

Q. And do you say it was intended that they would be issued to you when the underwriting took place and the shares were issued?

A. When they called for money, I would have to pay it. That was understood.

Q. And did you expect that to be on the occasion of the issue of the shares generally in the underwriting?

A. Well I don't know. Sometimes it is earlier, but whenever it was in any event.

Q. And about that time?

A. Yes.

Q. And you were going to pay a dollar per share. Is that correct?

A. That is right.

Q. Then, as we see from the prospectus in front of you, the shares were issued at \$3.00. Is that correct?

A. That is correct.

Q. But you did not pay for the shares, because Mr. King said—what did he say again, please, about you holding Dale Estate shares?

A. Well, they didn't think it would be wise for me to be holding Dale Estate shares if the British Mortgage was lending money to Dale.

Q. Would there be anything wrong with your holding Dale Estate shares which were listed shares on the Toronto Stock Exchange, if you paid the full purchase price for them?

A. I don't think there would be, but this was his deal, and his company and promotion and he said this to me and I said, 'All right, fine'.

Q. Well, that particular question didn't arise because you were not paying the full purchase price for them. You were getting them at a dollar?

A. I was—yes, I had the right to buy them at a dollar.

Q. And that right, I take it, had a value and subsequently you received a \$10,000 note of N.G.K. Investments in return for the surrender of the right. Is that correct?

A. That is absolutely right.

Q. Why did you get the right? In consideration of what?

A. In the first place . . .

¹³Evidence Volume 116, pp. 15804-13.

Q. Yes?

A. Why was I asked to buy?

Q. Why were you given an opportunity to buy this stock at a dollar?

A. Well, Mr. Shepherd, in every transaction that goes on and every promotion, the people who take the risk and get together and put it together, get stocks at less than it is issued and as I have said, I have been in many transactions with Mr. King since our University days when I—where I first knew him, and there have been many transactions where we have lost money.

I am one of those persons who is prepared to buy these risks.

THE COMMISSIONER: Mr. Gregory, what risk was there here? Remember, you offered this argument in the case of the Commodore Sales Acceptance minority interest and I did not ask you that then, although I rather wondered what the risk was there, but what risk was involved here?

A. The risk involved here, sir, was that things would never go and as a matter of fact, they ran into quite rough weather for a while. For instance in Frederick's I took a block of shares at two dollars that they said were going to have a public financing, probably two and a half or three dollars, they never got off the ground. You take a risk every time you buy a share of stock. And even when it appears to be that there is not any, they have to take this whole project where there has been bad management and they had to bring it into a state where they could be earning money and sell the shares.

MR. SHEPHERD: Mr. Gregory, in this particular case, there are two particular points arising out of your evidence, which I would like to discuss. You were getting the right to buy shares at a dollar, to be issued at \$3.00. There was not much risk attached to that, was there?

A. Mr. Shepherd, I have two answers to that. First, when I was asked if I wanted to get ten thousand shares at one dollar, I was not told, nor did they know, to my knowledge what the shares would be issued at, this was sometime before, and even when they came along and said shares were going to be issued at one dollar, they had to sell those shares. They can say, we are going to supply them to the public at this price, but that is far different from selling them as they did in this case.

Q. Well, what had happened? You did not take this risk, because you did not buy the shares, and subsequently, on your evidence, your right to buy them was acquired?

A. I committed myself to buy these shares.

Q. How?

A. Verbally.

Q. With whom?

A. With Mr. King right on the telephone, I committed—I said, 'All right, I will take ten thousand shares'.

Q. At one dollar?

A. At one dollar, and that is a commitment that you have to live up to if you want to stay in the securities business.

Q. It was not a statement you would have had any hesitation in living up to, because the shares sold at \$3.00?

A. If they had not, you would still have to live up to it.

Q. When did this discussion take place, Mr. Gregory?

A. I do not know when it took place, but it was right near the beginning, from the preliminary discussions, as far as I knew about it, and sometime before they got around to the question of a mortgage or a prospectus.

Q. Now, you said also something to the effect that it was common in transactions, for those who had helped to put it together, or some such phrase?

A. Yes.

Q. To receive some benefit in respect of shares, is that correct?

A. That is correct, and anybody who committed themselves to the preliminary money that was required for the nucleus share.

Q. What had you done in this particular case to help put the transaction together?

A. Well I had committed myself for ten thousand shares—and how many—300,000 shares being issued, and there were three groups already involved, and this was the extent of my interest.

Q. Were you aware that your 10,000 dollars net which you received, was paid for by Yarrum Investments?

A. I don't know. I did not know where it came from.

Q. Were you committed to this purchase of 10,000 shares of Dale Estate at one dollar at the time the mortgage application was received?

A. I am not aware of that, oh, the time it was received?

Q. Yes.

A. I find it hard to remember the exact financing, but I think it was—I think the application may have been received at the time I was committed and then I proceeded to get rid of it.

Q. I am wondering if you would apply your mind to this. The application was received on the same day that it was approved, the 31st of October, 1961. The prospectus was dated—I believe it is the 11th of December, 1961, but I will just look it up to be sure.

A. It takes quite a while when you are working on them, before they complete them and get them out.

Q. Yes the 11th of December, 1961, is the date of the prospectus. Now, do those dates assist you in determining when you did, as you say, commit yourself to the purchase of these shares?

A. I would have said in the early fall, that we started talking about them.

Q. When you committed yourself to purchase these shares for a dollar, orally, to Mr. King, did you ask him at what price the shares were going to be issued?

A. I don't think so.

Q. And did he tell you?

A. No.

Q. Did he know?

A. I don't believe so.

Q. They might have been issued indeed for fifty cents a share?

A. They could have, you had to set your market when the time came. It depended how much—for instance, whether they had the Latchmans involved at that time, the Federal Farms, which came quite an important element of management in this thing, it all entered into it, and I don't know when Mr. King asked me how much he was committed to these people, he had ideas of what he was going to do. But, as I say, this was quite a normal situation, there was six or eight of them he had done—I think only one or two he made money on, and on this one I find I did not make any money on, but I thought I did at the time.

THE COMMISSIONER: Are you saying, Mr. Gregory, that you were vital to this financing?

A. Not a bit of it, sir, I just say—

Q. In fact—

A. They needed a number of commitments and I made one of them.

Q. I agree, but let me have your view on this. When Mr. King realized the possibility of impropriety, if you took the shares, would he not have said, or would you not have said, well, all right, I want no part of it?

A. Well, I have been in there for a time then, things were progressing and there was some value, as it happened. Now, I don't know what value there was, but the suggestion was that Powell Morgan might be willing to give me something for it, and I certainly was not going to throw it away, if I could get something for it, so I simply asked and he suggested not making—not anything else—but he said will you take my note in N.G.K.

Q. I would have thought that Mr. King's answer—who was apparently possessed of some doubts—Mr. King would have said, 'Well, if you are president of the company, which is going to be lending this money, perhaps you should not get any benefit out of it.'

A. Well, he did not suggest that and I did not think that . . ."

Gregory had of course done a great deal more towards putting the transaction together than he described; he had authorized the lending of half a million dollars to the company which was a vital element in assembling the funds to buy the undertaking of the old company from its shareholders. As for his promise to take 10,000 shares at \$1 being of consequence in the financing, it is clear that these shares were simply given up by Yarrum Investments, out of the 60,000 which they held, and put for the time being in the name of Carl Solomon in trust. Gregory did not appear to comprehend the point that was put to him about the impropriety of accepting the \$10,000 N.G.K. Investments note for taking no risk at all, but I am inclined to think that this lack of comprehension was assumed. In concluding his examination on this point counsel put the inescapable question.¹⁴

"Q. Is there any relationship between that \$500,000 mortgage for twenty years on terms that the mortgagor can pay off all or any part without bonus on thirty days notice and may have a discharge of any ten acre parcels to build an office building, and the like, is there any connection between British Mortgage granting that loan and you receiving the right to buy 10,000 shares of Dale Estate at one dollar?

A. I am glad you asked me that question, sir, because directly, as far as I was concerned, there was absolutely no relationship whatever. The mortgage came up afterward I was called to have it, and I got out of my personal position in order to let the company in with a good loan, and they got a bonus of 10,000 shares as well.

Q. I am sorry, I do not understand what you say, 'you got out of your personal position'?

A. With Dale Estate, yes.

Q. For \$10,000?

A. Yes, but I might have made twenty in another month or two.

Q. Mr. Gregory, if you had held on to Dale Estate you would not have made money.

A. It depends on when I sell, I guess.

Q. You have a full opportunity now to make any point you wish to make respecting that transaction. Can I pass on it?

A. Yes, thank you."

By accepting the \$10,000 note which, according to Walton's memorandum, was purchased by the Trio at a 5% discount for \$9,500, it would not appear that Gregory "got out of his personal position". Although the note was issued with no attempt to conceal the identity of the payee, it was otherwise with the 10,000 shares of The Dale Estate purchased, as they were, from Yarrum Investments by Hilltop Holdings and put in Solomon's name.

¹⁴Evidence Volume 116, pp. 15815-6.

It will be noted on Table 74 that the principal amount of The Dale Estate's mortgage to British Mortgage & Trust remained outstanding at \$500,000 at the fiscal year-ends for 1962, 1963 and 1964. At July 19, 1965, \$870,118 is shown as outstanding. This is explained by an application made by The Dale Estate to British Mortgage & Trust on January 15, 1965 for a mortgage loan of \$400,000 for a term of fifteen years, bearing interest at $7\frac{1}{2}\%$ per annum, approved by the executive committee on January 19. This was to finance the purchase by The Dale Estate of the assets and undertaking of Walter E. Calvert Limited, another Brampton company in the same line of business, and was to be a first mortgage on the Calvert property and a second and third mortgage on the Dale Estate properties, already encumbered by the first mortgage to the trust company. Some reduction on the principal owing on this mortgage had been made by July 19, 1965.

Severn Investment Company Limited

The practice of officers of British Mortgage & Trust Company receiving shares in companies to which mortgage loans were advanced may be illustrated by another transaction which, although abortive, shows the extent to which it was evidently sanctioned by the president and managing director. Severn Investment Company Limited was a finance company of modest size, carrying on business in Orillia, Ontario. On June 12 its president, Mr. J. H. Jones, wrote on behalf of his company to the president of British Mortgage & Trust as follows:¹

"May 19, 1964,
Orillia, Ontario.

Mr. Wilfrid P. Gregory, Q.C.,
President & Managing Director,
British Mortgage & Trust Company,
1 Ontario Street,
Stratford, Ontario.

Dear Mr. Gregory:

Our Company is interested in obtaining some Short Term funds and we would like the opportunity of discussing the matter with you or one of your executives.

Our Company has been established six years and we are licenced under the Canadian Small Loans Law. Our total outstandings are approximately \$540,000.00. Both the writer and Mr. Gordon H. Dawes, General Manager, have had considerable experience in our field and we believe that our administration will withstand the closest investigation.

Mr. E. R. Rowlands has been known to me for a number of years and I have discussed this matter with him. It would appear that we

meet the basic requirements and there would seem to be basis for further discussion.

We will look forward to hearing from you at your early convenience.

Yours very truly,

SEVERN INVESTMENT COMPANY LTD.,

JHJ/LW

J. H. Jones — President."

This letter was answered, on May 21, by J. D. Gordon, the assistant treasurer of British Mortgage & Trust who, after saying that the trust company's funds were almost entirely being directed into the mortgage market, "since this is the primary function of our company", offered to examine the financial statements of Severn Investment with a view to possible advances in the future. These statements were forthcoming for the year 1963 and the first four months of 1964,² and were sent to Gordon in Stratford on June 2. In the letter which accompanied them the following was said about the Orillia company:

"Our business is growing rapidly and with our present progress we expect to be doing a million dollars annually in our area in the very near future.

We are interested in establishing ourselves with your Company and we are particularly interested in clearing our present obligations to our Factors.

We would appreciate the opportunity of discussing the matter with you or Mr. Gregory at your Stratford offices. We would of course welcome your representative to inspect our offices and review our business in general. We are quite certain that you would be most satisfied with our operation and that you would be interested in our future growth picture.

In anticipation of hearing from you we are

Yours very truly,

SEVERN INVESTMENT COMPANY LIMITED,

JHJ/LW

J. H. Jones — President."

Gordon replied to this in a letter to Jones on June 8. He read him a mild lecture about the reduction of the Severn surplus during 1963 through making dividend payments, but added that, because of the personal interest which Jones and Dawes were taking in their company, Gregory and himself were interested in further discussion of their requirements. An appointment for July 15 was arranged and, after a meeting in Stratford on that day, Wilfrid Gregory wrote the following letter to Jones dated July 17:

"Dear Sir:

It was a pleasure to meet you and Mr. Dawes yesterday. From what you told Mr. Gordon and myself, and from what we have heard about you, you are establishing a sound and progressive Finance Company

²Exhibits 4570-1.

which is providing good service for your district. Because of this favourable impression of yourselves, we are prepared to take an active, though minor position in helping you develop your Company.

We will be prepared, as you require it, to advance up to \$500,000.00 on relatively short-term notes, on the following conditions:

1. These notes will be secured with 125 per cent of chattel mortgages in good standing.
2. The total amount of secured notes outstanding from whatever source, will not exceed 350 per cent of your capital, plus unsecured indebtedness.
3. Arrangements will be made in the near future to have those secured held by a trust company under a trust agreement for the benefit of the secured note holders.
4. You will sell to this Company 20,000 shares at twenty-five cents per share. (We know that there are not that many unissued shares. You will have to find the remainder.) We will wish to retain our twenty per cent interest in any future equity financing.
5. We will have the right to nominate one director for election to the Board of Directors. This will, in all likelihood, be Mr. J. D. Gordon, our Assistant Treasurer.
6. While we have no desire to hold down the remuneration, we feel that the salaries of Mr. Dawes and yourself should not be increased from the present level without the approval of the Board of Directors.

There are a few further thoughts which I have which I present to you for your consideration. I think you would be wise not to increase the capitalization of the Company for the time being (about a year). This will permit you to sell more preferred shares and unsecured notes but not common shares. It is an excellent excuse for not being able to sell common shares. This will result in the equity not being further diluted.

One of your early considerations will have to be that of raising new junior capital. I realize you are getting out unsecured notes repayable on demand. I suggest Series A of a longer term issue of unsecured debentures. You will have to be prepared, possibly, to give warrants with them. While the structure of your capitalization depends largely on your financial agents and your lenders, you might be able to work something out like the following:

Consolidated net worth (common and preferred stock shares plus preferred earning)	—100%	
Junior subordinated	—100%	
Unsecured debentures (secured subordinated)	—125%	of total of first two
Secured notes	—350%	of total of previous three

If this were possible, it would give you a quite profitable borrowing base. You should select an investment dealer in the relatively near future.

As soon as you let us know that the terms of this letter are satisfactory, we shall start sending money to you, as required, starting with a payment for the common shares.

We trust we can look forward to the beginning of a long and mutually advantageous relationship.

Yours very truly,
‘Wilf Gregory’ ”

This letter, of which no copy appears in the British Mortgage file,³ was apparently preceded by one in Gregory’s handwriting on private stationery, dated July 16, which reads:

“Dear Mr. Jones, —

I think it would greatly increase the interest which Mr. Gordon and I have in Severn if we owned some shares personally. Our advice to you would then be more extensive and detailed. Would it seem reasonable to suggest that you sell at the same price, one thousand shares to Mr. Gordon and four thousand shares to me.

We are confident that a flow of money added to your ability in lending, can create a profitable operation in the future.

Sincerely,
‘Wilfrid P. Gregory’ ”

No copy of this letter, either, appears in the trust company’s file.

The financial statements of Severn Investment for the four month period ended April 30⁴ and the six months period ended June 30, 1964⁵ show earnings of approximately 5¢ and a book value of 49¢ per share; a conservative estimate of the value per share would lie somewhere between 45¢ and 50¢. Messrs. Jones and Dawes were therefore being asked to find 25,000 common shares when only 18,000 remained in the treasury.⁶ There was nothing unusual in this type of financing, or about the request by British Mortgage & Trust for a substantial number of shares at half their ascertainable value to provide an incentive for the loan it was asked to make. But the request for an additional 5,000 shares to be held by Gregory and Gordon to ensure their “more extensive and detailed” advice to the finance company, made under circumstances which strongly suggest concealment from the other directors of the company, must be regarded as unusual and discreditable. It was not, moreover, suggested by Gregory in his evidence that there was any intention on his part to kill the contemplated arrangement by such a demand.

³Exhibit 4573.

⁴Exhibit 4571.

⁵Exhibit 4572.

⁶Exhibit 4572.

That, however, was its effect, and on July 27 Jones wrote to him referring, it will be noted, to the explicit typewritten letter of July 17, but not to the handwritten note of July 16.

"Dear Mr. Gregory:

We thank you for your letter of July 17th, 1964 and also for the kind reception you gave us in Stratford.

We have now had an opportunity to fully assess the details of the plan you propose for us. Initially we did not anticipate your proposal for participation in our Company, and we were therefore not prepared to discuss the matter adequately.

After giving the entire proposal a great deal of consideration, we have concluded that at least for the foreseeable future we do not wish to sell Common Stock in our company.

We would still be interested in discussing the possibility of your Company lending us short term money, with Mr. Gordon as a Director, holding a token share. If you feel that there is basis for discussion here we will be pleased to hear from you at your convenience.

We shall of course treat our negotiations as entirely confidential, and we are sure that you will reciprocate.

Once again our sincere thanks for your kind consideration of our application. We will look forward to hearing from you.

Yours very truly,

SEVERN INVESTMENT COMPANY LTD.,

J. H. Jones — President."

There the matter apparently ended. The correspondence was discussed by counsel with Gregory in their preliminary meeting about a week before he testified and was put to him when he gave evidence before the Commission. In answer to an invitation to make observations about it he said:⁷

"A. Well, Mr. Shepherd, this came about through a mutual friend who phoned me. A friend in the finance business, who phoned me and said that these chaps were pretty decent fellows doing quite profitably in a small way in their area, and could stand some help, and possibly we could get together, and I said to send them down, and I wrote and had Mr. Gordon looking after it.

They finally came down and after our discussion I made them a written commitment as in the letter of July the 17th, telling them what the situation was and what we could do for them, and then after that letter had been done, before it had been mailed, Mr. Gordon and I were discussing it and I suggested he go on the Board and he said, 'These people are going to take a lot of help and a lot of your kind of knowledge if you expect to really make the company go', and he was referring to the sort of thing of financing, because when these small finance companies get to a certain stage there is no trouble in getting the

business. It is in finding the money coming into them, and my knowledge through Atlantic and others, of how to finance these small companies—and it was probably a very foolish thing to do, especially in this way, instead of waiting until the next time, I saw them, but I enclosed with their commitment letter—it was at the end of the day and I just dashed this off—and it was purely a suggestion.

It did not interfere with this commitment letter. If they had wanted to take this up all they had to do was write back and say, 'We accept your terms in this letter', and it was just the same as if it had been done verbally, as if it was done in this way. And, as I say, it would have meant a lot more work, night work, and going on and trying to find contacts for them more than they ordinarily do for one of our investments, but we were prepared to do it if they wanted to do it, but they didn't want in fact to let go any of their common shares, as you have mentioned, so the transaction did not proceed.

We were not—British Mortgage was not interested in taking a position in the company, unless we saw some possibility of benefiting from their improvement which we might make possible.

Q. Do you agree upon reflecting, Mr. Gregory, that it was an improper proposal to put forward to them?

A. I don't agree it was improper, sir. I agree it was done in a—in a foolish manner.

Q. Were you not obliged as the principal officer of British Mortgage to give advice extensive and in detail, for the benefit of British mortgage, which was going to be a shareholder?

A. Not nearly to that extent that you have to do if you are going to be a shareholder and director yourself.

Q. Did you feel any concern at all about the effect upon Mr. Gordon of being aware of this proposal being made?

A. No, I thought I was—that it was a generous—a reasonable division of the responsibility or remuneration, you might say.

Q. Well, have you had an opportunity to deal with such matters as you wished to reveal?

A. That is all I wish to say and I may just add this final thing—it is the sort of thing you do somewhat at an impulse, and the next day—I wouldn't have done it, but it got done and that was the reason for doing it.

THE COMMISSIONER: Well, Mr. Gregory, if it was not improper in your opinion, why was it foolish?

A. It was foolish to do it in handwriting just because of what you think about it. I don't think it is improper, if I had talked to them as part of their transaction and said, 'Now, gentlemen, British Mortgage has 20 per cent and we will put up our money and do these things if you want, but if you want the added work from us to help you really make this company go, if you want me to go out finding money for you I can't.' I did not feel I could do that, or do not usually do that as an officer of the company. This involved a lot of extra work.

Q. What you mean when you talk about foolishness then is that because it was a holograph letter it was given the appearance of concealment which you say is not justified?

A. That is right, sir. It was purely a suggestion to them which they did not even refer to, and they could have turned down simply if they did not like the idea.

Q. And they did turn it down?

A. Not that letter. That letter had nothing to do with their decision. This is important. They didn't—British Mortgage had asked 20,000 shares of their equity as part of the—as one of the conditions for lending them money, which is quite common, and they did not want at that time to part with any amount of the equity. None whatever.

Q. Well, let us leave it at this. As far as you know, it was not your handwritten letter that decided—

A. As far as we were concerned.

Q. In that respect.

A. It had no—no, none whatsoever.

Q. There is no indication in the letter?

A. No, no, no indication from their letter. There is no indication.

Q. Go ahead.

MR. SHEPHERD: Can you assist us at all as to why the carbon copy of the letter of commitment, that is the typewritten letter of commitment, is not in the British Mortgage file?

A. No, I did not know we had a file relating to Severn until I saw what you showed me or—can I tell why, one letter is dated the 17th, and my letter is the 16th.

Q. I had presumed that perhaps the typewritten letter did not get typed until the next day, is that probable?

A. It may not.

Q. Evidence is before the Commission to the effect—

A. Pardon me.

Q. Yes?

A. This is dated in 1964.

Q. Yes, I believe so.

A. It is just possible that this may have got put in one of my personal files. It should not have been. It was in Severn, and Mr. Gordon had it, but this is possible.

Q. You mean the carbon copy of the commitment letter might have got into a personal file?

A. Yes."

More will be said about the fate of Wilfrid Gregory's personal files at the conclusion of this chapter. The evidence and the documents were subsequently put to J. D. Gordon when he testified to the Commission, and specifically the proposal that Gregory should have 4,000 and Gordon 1,000 shares at the price of 25¢ per share.⁸

“Q. Now, what discussions were had between you and Mr. Gregory relating to this proposal?

A. I am not certain whether I saw this letter before it was mailed or not. Although, I am sure that Mr. Gregory indicated that he had asked them to appoint me as a director in his other letter.

Q. Yes?

A. And I knew that he had asked them to issue shares to me. At the time, I assumed that it was in order to qualify me as a director.

Q. Did you know the number of shares which he was asking for for you?

A. Yes, I did.

Q. And the price at which the shares would be issued?

A. Yes.

Q. Was it intended too, that you would pay for those shares out of your own funds?

A. Yes, as far as I knew.

Q. What did you know of the interest which Mr. Gregory was proposing to have personally, the 4,000 shares?

A. I believe I knew about that part of the letter as well.

Q. What did he say about it?

A. He didn't make any comment to me about it other than what was in the letter.

Q. What did you think about it?

A. I didn't give it a great deal of thought actually. I was more interested in the fact that I was probably or possibly going to become a director of the company and I thought it would be a good opportunity, good experience.

Q. Had you ever been a director of a company before?

A. No, sir.

Q. Is there any other instance in which you and Mr. Gregory held any securities in the same company, other than British Mortgage?

A. No, sir.

Q. And is there any other occasion similar to this, to your knowledge, in which Mr. Gregory made any such proposal whereby you would both have some shares?

A. No, sir.

⁸Evidence Volume 119, pp. 16224-6.

Q. Are you familiar with the—sorry—Mr. Gordon, just before I leave this point, Mr. Gregory's evidence was generally to the effect that respecting this proposal for the aggregate of 5,000 shares for Mr. Gregory and yourself personally, that it was your initial suggestion that you and Mr. Gregory should have these shares allocated to you at this price because of all the time it would take to look after the affairs of Severn. Is that correct?

A. No. I don't recall saying that or words to that effect.

THE COMMISSIONER: Well, you say you don't recall, Mr. Gordon?

A. I am sure I didn't say it, sir."

Conarm Developments Limited

One example of large mortgage loans made to sub-division developers is of importance because of the joint participation of British Mortgage & Trust Company and Aurora Leasing Corporation. Conarm Developments Limited was incorporated on January 11, 1963 to develop 800 acres near Hazeldean in Carleton County, a tract lying south of King's Highway No. 15 on the western outskirts of the city of Ottawa. Its promoter was an Ottawa builder by the name of W. G. Connelly who was introduced to C. P. Morgan by their mutual friend, Mastino Della Scala, and the incorporation of Conarm Developments was the fruit of their meeting. According to Della Scala, Morgan had turned down his proposal to assist Connelly in the first instance but, armed with a schedule of cash requirements prepared by Connelly,¹ Della Scala returned to the attack and with his customary persuasiveness succeeded in arousing Morgan's interest. Connelly explained to Della Scala, according to the latter's evidence on the subject,² that he was one of a group of builders in Ottawa assembling a tract of land on the western outskirts of the city to provide work for themselves for the next ten years or more. They were looking for financial assistance in subdividing the land, which consisted of 600 acres of farm land in Goulbourn Township and 200 acres in Nepean Township, and providing the sub-division lots with services. The land was owned by the builders' own company, Valley Land Development (Ottawa) Limited, which had bought it from Messrs. W. Bradley, E. Grierson, W. Sparks, and P. Grierson and given back mortgages amounting to \$692,318. Connelly's plan was to have an intermediary buy the land at its original cost, finance the provision of services to lots and sell them back again to Valley Land Development. The intermediary would be called upon to assume the existing mortgages and pay them off in due course.

The operations of Conarm were investigated by Mr. Frederick S. Mallett, C.A., a member of the firm of Clarkson, Gordon & Co. practising in its Ottawa office, who testified before the Commission on May

¹Exhibit 1954.

²Evidence Volume 28.

6, 1966.³ The first issue of common shares occurred on April 11, 1963 at which time 3,000 were issued to Connelly, 2,999 to R. H. Cuzner in trust, 998 to Mastino Della Scala and 3,000 to Harry Wagman, the remaining three shares being held by C. P. Morgan, Helen Stewart and Cuzner whose firm, Cuzner & MacQuarrie of Ottawa, had incorporated the company. Subsequent transfers and the position at June 22, 1965 are illustrated below together with the distribution of preferred shares at December 22, 1964 and May 12, 1965.⁴

COMMON SHAREHOLDERS

	April 11, 1963	Transfers	June 22, 1965
W. G. Connelly	3,000 sh.		3,000 sh.
R. H. Cuzner	1		1
R. H. Cuzner—in Trust	2,999	(2,999)	
Mastino Della Scala	998	4,999	5,997
C. Powell Morgan	1		1
Helen Stewart	1		1
Harry Wagman	3,000	(2,000)	1,000
	<u>10,000 sh.</u>		<u>10,000 sh.</u>

PREFERRED SHAREHOLDERS

	December 2, 1964	Transfers	May 12, 1965
W. G. Connelly	9,000 sh.		9,000 sh.
Mastino Della Scala	3,000		3,000
C. Powell Morgan	9,000	(9,000)	
C. Powell Morgan—in Trust	6,000	(6,000)	
Harry Wagman—in Trust	3,000	(3,000)	
Chartered Management Consultants (of Canada) Ltd.		18,000	18,000
	<u>30,000 sh.</u>		<u>30,000 sh.</u>

According to Cuzner's handwritten memorandum,⁵ the 10,000 shares issued on April 11 were subscribed for at 50 cents per share and two cheques for \$1,500 each were received from Morgan, one being referred to as "for Wagman", and the other not identified but, from Cuzner's evidence⁶ in payment for the shares held in trust by him, which were so held for Morgan himself and were the subject of a declaration of trust which has not been found. The cheque stubs for account No. 13324 at the Guaranty Trust Company of Canada—the Trio account⁷—show that

³Evidence Volume 28.

⁴Exhibit 1960.

⁵Exhibit 1961.

⁶Evidence Volume 28.

⁷Exhibit 806.

a cheque was issued on April 24 "in favour of C. P. Morgan—to acquire 30% of shares of Conarm".

In the meantime, in January, two agreements had been entered into between Conarm and Valley Land Development, the first binding the former to buy approximately 800 acres (2,400 lots, 39.5 acres for commercial development, 44 for industry, 21.7 for schools and 32.3 for "public open space") for \$1,647,910, to be paid by the assumption of first mortgages to the vendors amounting to \$692,318, a second mortgage to British Mortgage & Trust Company for \$90,000 and a third mortgage to Vaan Interests Limited for \$115,592, or \$897,910 in all, by giving back a mortgage to Valley Land Development for \$550,000 and by paying the balance of \$200,000 in cash. Conarm undertook to service the lots by providing an underground fuel oil distribution system, underground telephone cables, roads, curbs, street lighting, sewers and water, while Valley Land Development assumed the cost of installing hydro-electric power distribution; Conarm also agreed to discharge the British Mortgage & Trust mortgage by May 1. The second agreement provided for the buying back by Valley Land Development of 238 lots for \$778,290.24, 10% of which was to be paid as a set-off against the \$200,000 in cash required under the first. Since the date of closing was February 1, 1963 and Conarm did not receive its contributed capital of \$5,000 until April 11, the balance to close of \$113,755, after adjustment of \$8,353 for work in process, was borrowed from Aurora Leasing Corporation, the evidence of debt being a promissory note with no security for the loan.

The "Overall Report—Estimate and Forecast 1963-1966", which Della Scala had produced for Morgan's benefit towards the end of 1962,⁸ estimated costs, including land at \$1,650,000 and services at \$3,300,000, at a total of \$6,400,000 and receipts from the sale of residential lots, the 200 acres in Nepean Township, and 60 acres set aside for commercial purposes, at \$9,438,000, providing an estimated minimum return of \$3,000,000. The difference between estimated expenditures of approximately \$1,000,000 for 1963, 1964 and 1965, declining to \$890,000 in 1966, and expected income from the sale of lots was \$260,000 in 1963, \$250,000 in 1964 and \$125,000 in 1965; the break-even point would be reached in 1966. Thereafter 1,600 lots would be available at an average cost of \$1,500 per lot, together with part of the commercial and industrial land not disposed of and the whole of the 200 acres in Nepean Township. It was expected that the 238 lots bought by Valley Land Development would be disposed of in 1963 and the full purchase price payable to Conarm would be realized. In fact, up to January 31, 1964, Valley Land Development had only purchased 46 lots for building and, in order to meet its obligation to buy the additional 192 by February 1, 1964 for approximately \$680,000, had borrowed \$375,000 from

⁸Exhibit 1956.

BRITISH MORTGAGE & TRUST

British Mortgage & Trust secured by a first mortgage on 143 lots, registered on January 31, 1964,⁹ and given a mortgage to Conarm together with a promissory note to provide the balance secured by the remaining 49. During the second fiscal year ended January 31, 1965 only 33 lots were sold instead of 200 and none of these by Valley Land. In August 1964, in the middle of this fiscal period, Conarm had been compelled to buy back from Valley Land Development all the serviced lots on which no building had then taken place, paying the same price as it had charged in February, 1963 and assuming the outstanding mortgages, including that of British Mortgage & Trust. During the six months' period ended July 31, 1965 Conarm sold 32 lots, so that during the whole period from February 1, 1963 until July 31, 1965 only 111 lots had been sold against a projected sale of 538. Since the land in question was some fifteen miles from the centre of Ottawa and outside the National Capital Commission's "Green Belt", it is clear that the failure of Valley Land Development to attract purchasers was the simple cause of the difficulties of Conarm Developments, which may be best illustrated by reproduction of the comparative balance sheets and statement of sources and application of funds prepared by Mr. Mallett:¹⁰

CONARM DEVELOPMENTS LIMITED COMPARATIVE BALANCE SHEETS

	February 1, 1963 (original acquisition)	January 31, 1964	January 31, 1965	July 31, 1965
Assets:				
Current assets.....		\$ 143,519	\$ 81,632	\$ 138,504
Homes under construction (net)			148,626	167,775
		143,519	230,258	306,279
Land and services.....	\$1,647,910	1,945,034	2,357,308	2,356,363
Second mortgages receivable..			4,328	36,737
Deferred charges.....			95,846	79,672
Fixed assets.....		15,965	19,578	22,430
Total assets.....	\$1,647,910	\$2,104,518	\$2,707,318	\$2,801,481
Liabilities and capital:				
Current liabilities.....	\$ 8,353	\$ 179,523	\$ 360,813	\$ 355,394
Deposit—Valley Land.....	77,892	65,157		
Mortgages—				
First mortgages assumed....	692,318	610,168	485,919	435,919
B M & T (to Valley Land)....	90,000			
Vaan Interests.....	115,592	90,592	65,592	65,592
Valley Land Dev.....	550,000	550,000	512,704	402,704
B M & T (to Conarm).....			446,000	368,000
Total mortgages.....	\$1,447,910	\$1,250,760	\$1,510,215	\$1,272,215
Sundry notes and debentures...			15,000	27,000
Advances—Aurora Leasing....	113,755	802,534	1,038,835	1,345,000
Share capital.....		5,000	5,000	35,000
Surplus (deficit).....		(198,456)	(222,545)	(233,128)
Total liabilities and capital.	\$1,647,910	\$2,104,518	\$2,707,318	\$2,801,481
Working capital, including homes under construction (net).....	\$ (8,353)	\$ (36,004)	\$ (130,555)	\$ (49,115)

⁹Exhibit 1969.

¹⁰Exhibits 1967-8.

SOURCES AND APPLICATIONS OF FUNDS
FOR PERIODS ENDING JANUARY 31, 1964 AND 1965, AND JULY 31, 1965

	<u>January 31, 1964</u>	<u>January 31, 1965</u>	<u>July 31 1965</u>
Sources of funds:			
Mortgage advances—			
Valley Land Dev. (net).....		\$ 7,547	
B M & T.....		500,000	
Sundry notes and debentures.....		15,000	\$ 12,000
Aurora Leasing.....	\$688,779	236,301	306,165
Capital stock subscriptions.....	5,000		30,000
	<u>693,779</u>	<u>758,848</u>	<u>348,165</u>
Less applications of funds:			
Funds required for operations—			
Operating loss.....	198,456	24,089	10,583
Non cash credits (charges) to income			
Second mortgages on homes sold.....		4,328	32,409
Valley Land Dev. deposit transferred to			
income.....	12,735		
Cost of land sold.....	(73,390)	(52,805)	(57,280)
Depreciation.....	(1,155)		
	<u>136,646</u>	<u>(24,388)</u>	<u>(14,288)</u>
Funds applied to land—			
Services.....	370,514	296,679	(50,443)
Interest.....		168,400	106,778
	<u>370,514</u>	<u>465,079</u>	<u>56,335</u>
Mortgage principal repayments—			
First mortgages assumed.....	82,150	124,249	50,000
B M & T (to Valley Land).....	90,000		
Vaan Interest.....	25,000	25,000	
Valley Land Dev.....		110,000	110,000
B M & T (to Conarm).....		54,000	78,000
	<u>197,150</u>	<u>313,249</u>	<u>238,000</u>
Deferred charges.....		95,846	(16,174)
Fixed assets acquired (net).....	17,120	3,613	2,852
	<u>721,430</u>	<u>853,399</u>	<u>266,725</u>
Difference, being increase (decrease) in working capital.....	<u>\$ (27,651)</u>	<u>\$ (94,551)</u>	<u>\$ 81,440</u>
Lots sold.....	<u>46</u>	<u>33</u>	<u>32</u>

Although it is apparent that Conarm lost \$198,000 during the year ended January 31, 1964, and a further \$24,000 at the end of the following year, the size of these losses does not accurately indicate the need for additional money. In the former year the loans from Aurora Leasing, its only source of funds other than the sale of lots, increased by \$688,779 out of which it required \$136,646 for operations, \$370,000 for services to lots, \$197,000 for the repayment of mortgage principal and \$17,000 for the acquisition of fixed assets. During the year ended January 31, 1965 it spent \$296,679 on services, \$168,000 on interest charges, which were capitalized by charging them to the land account rather than to operations, and a further \$313,000 which was required for repayment of mortgage principal. Necessary expenditures amounted to \$853,000 and were met by borrowing an additional \$236,000 from Aurora Leasing, some \$15,000 from other sources for which notes and debentures

were given, and \$500,000 from British Mortgage & Trust. The last was accomplished by Conarm assuming the balance of the \$375,000 mortgage given to the trust company by Valley Land Development which was re-negotiated to provide an additional \$125,000.

C. P. Morgan as Trustee for British Mortgage & Trust Company

The arrangement for this new financing was made at a meeting in Wilfrid P. Gregory's office in Stratford, evidently held on July 22, 1964 according to a letter addressed to "Dear Wilf" from Connelly to Gregory, dated July 23.¹ Cuzner, who attended the meeting, testified on oath that he was accompanied by Connelly and Morgan and it was also Della Scala's understanding that Morgan was there. Gregory swore that he was not and said that Morgan had never been in his office at Stratford. The question was not put to Morgan himself, but since the Conarm affair was Cuzner's only contact with Morgan it is unlikely that he was wrong on this point. In any event Gregory agreed that the introduction of Connelly was made by Morgan and the final form of the arrangement provided for a new mortgage to secure a loan of \$500,000, the discharge of the previous mortgage, and permission to obtain partial discharges of the mortgage as it affected individual lots upon payment of \$1,000 for each lot and \$3,000 for each acre of commercial land and open space covered by it. British Mortgage & Trust was to hold a first mortgage on 136 serviced lots, a second mortgage on 50 lots, 30 acres of the commercial land and a one-acre church site and either a second or third mortgage on the remaining vacant land owned by Conarm. Also discussed was an option agreement providing for the sale to British Mortgage & Trust of a 10% interest in the equity of Conarm which was the subject of the concluding paragraph in Connelly's letter of July 23: "The other matter which we discussed dealing with equity in Conarm does not fall within the purview of the mortgage arrangement. This will be covered separately at the earliest possible date." Gregory, in a reply dated July 27, said that "while the bonus of ten per cent of the equity in Conarm does not come within the terms of the mortgage it is an essential part of the whole transaction," and insisted that this part of the arrangement should be agreed upon before the mortgage money was advanced. Connelly acquiesced by return mail saying, "Mr. Cuzner has prepared the minutes and resolution authorizing the transfer of 1,000 shares of Conarm common stock to British Mortgage & Trust Company for \$1.00 and other considerations from stock held in trust through Mr. Morgan". The matter was settled by Morgan executing on July 30, 1964 a declaration of trust that he held 1,000 common shares of the capital stock of Conarm Developments in trust for British Mortgage & Trust Company and "that the said shares were purchased with its money".

¹Exhibit 1972.

This declaration, witnessed by Mastino Della Scala, was evidently forwarded to the trust company because it was found in the files of Victoria and Grey Trust Company.²

The new mortgage for \$500,000, at 10% for three years with principal payments of \$75,000 half-yearly, deserves attention. Although the rate of interest was high for the period at which it was negotiated, it compares favourably for the mortgagor with the mortgage given by Valley Land Development which it replaced in respect of payment for the obtaining of partial discharges, as required to release lots for sale. Where Valley Land was required to pay \$3,000 per lot for a partial discharge of its mortgage, Conarm was to pay only \$1,000. The former requirement was calculated to be sufficient to maintain the security of the mortgagee, so that if the privilege of partial discharge were fully exercised British Mortgage & Trust would not find itself owed a substantial balance on principal without security. In the case of the latter, by payment of only \$139,000 Conarm could obtain partial discharges of all lots and lands in respect of which the mortgage to British Mortgage & Trust was in first position. It was in second position in respect of 50 lots on the registered plan and 30 acres of commercial land, and the partial discharge privileges would have entitled Conarm to a discharge of the mortgage in respect of all these lands on payment of \$140,000. If these two steps had been taken, the trust company would have been left with only the unserviced farm land as security for an outstanding balance of \$221,000. In respect of these 720 acres of vacant farm land, unimproved as it was, the trust company's mortgage ranked behind vendors' first mortgages amounting to \$580,510 and second and third mortgages to Valley Land Development securing \$512,704, without taking into account the mortgage to Vaan Interests Limited, outstanding in the amount of \$90,000 on the most easterly portion, including the 200 acres in Nepean Township adjacent to the "Green Belt". Therefore, in the event of part discharges being obtained to the fullest extent, British Mortgage & Trust Company was either in fourth (effectively third) or fifth position behind mortgages amounting to over \$1,000,000, with respect to its security of unimproved farm land for a potential balance of \$221,000 outstanding. At the time when Mr. Mallett's evidence was given on May 6, 1966 only 21 serviced lots remained as security for British Mortgage & Trust's first mortgage, the rest having been released upon payment of \$1,000 per lot.

If British Mortgage & Trust was in a precarious position, Aurora Leasing was even more so. At July 31, 1965 Conarm owed Aurora, including interest accrued and unpaid, approximately \$1,345,000, and by letter dated January 19, 1965, signed by J. C. Laidlaw and W. E. Pahn, from Aurora to Conarm,³ the former agreed that the promissory

²Exhibit 1973.

³Exhibit 1975.

notes received from the latter should not be due, nor the loans called, for three years from their anniversary dates in 1965; in the meantime interest at 10% would accrue, but would not fall due until 1968. None of these advances were in any way secured and Wilfrid Gregory professed in his evidence not to know anything about them. The meeting of July 22, 1964 must indeed, according to his account, have been perfunctory.⁴

“Q. Your recollection is that Mr. Morgan was not at that meeting?

A. Mr. Morgan made the arrangements for it; he knew Connelly and he sent him to me.

Q. Mr. Cuzner gave evidence about this before the Commission. Do you recall whether at that meeting a financial statement of Conarm Developments Limited was produced and discussed to determine whether it was a reasonable loan to make?

A. I don't recall. It is quite possible.

Q. Did you have any knowledge—

A. May I emphasize again: We lent on the security, not on the—on the ownership because these things shift so much from one company to another in these developments. There is very rarely anything behind a developer. You would like to have it but you just can't get it.

Q. You would be concerned, would you not, to determine whether or not the covenant to pay was based on anything; you might make the loan anyway but you would be concerned to see that?

A. Well, we would be interested to see it.

Q. And you would determine that by looking at the company's financial statement?

A. Usually, or getting a bank statement.

Q. In connection with this loan, did you know that Mr. Morgan had an interest in Conarm Developments Limited?

A. I did not.

Q. Just to assist your recollection, I will show you the documents as well. Do you not recall this is the loan where British Mortgage received as a bonus in connection with their mortgage a thousand shares of Conarm Developments Limited?

A. Yes. Did we ever get it? I know we were to get it.

Q. You got a Declaration of Trust from Mr. Morgan. Do you recall that?

A. We asked for certain things, which I believe we got. As far as Mr. Morgan was concerned in it, I felt he was lending money to Connelly

⁴Evidence Volume 116, pp. 15766-8.

and he wanted us to—suggested there was an area for us to take first mortgage finance. I did not know—If he did I still don't know. If you tell me he had some interest—equity interest in it, I was not aware of it and I am still not aware of it.”

After showing the correspondence with Cuzner to the witness, counsel produced Morgan's declaration of trust as to holding 1,000 shares of Conarm for British Mortgage⁵ and resumed.⁶

“MR. SHEPHERD: With the assistance of those documents, do you recall whether or not you had any reason to believe that Mr. Morgan had personally an interest in Conarm?

A. Well, I had no reason to believe. I felt that he was acting in some other capacity.

Q. Did you know what capacity?

A. No, I didn't. In fact, as far as this agreement of trust was concerned, and I knew that this was the arrangements, I never saw this document, but I knew he had brought us together and I wasn't surprised that he was the one that was sort of seeing that we got looked after.

Q. Would you look please, at Exhibit 1964. This is a financial statement of Conarm Developments Limited, as at 31st January, 1964, prepared on the 20th of March, 1964 and it appears to be the last financial statement of this company prior to this mortgage application.

I direct your attention to the front page, the balance sheet under liabilities appear the words 'Long term notes payable Aurora Leasing Corporation Limited 10%. \$802,533.75'.

Can you assist the Commission with the statement in front of you, as to whether or not you were aware that Aurora was financing this venture?

A. When you show me that financial statement, I know that I have never seen it.

Q. Did you know from any other source that Aurora was financing this venture?

A. I did not.

Q. Would it be fair to say then, that in making this particular loan to the best of your recollection, you did not see a financial statement of Conarm?

A. I didn't see it, and I was never told. I can't say of course, whether anybody else in our office saw it, but I was not told about the interest of Aurora in this transaction.

From my point of view it was simply a straight mortgage transaction. Connelly seemed an able, good builder and we went ahead.

⁵Exhibit 1973.

⁶Evidence Volume 116, pp. 15780-3.

Q. Is this an unusual practice, or was it a common practice for British Mortgage to make a loan generally of this type and this size without making enquiry into the worth, if there was worth, of the covenant of the borrower?

A. I mentioned earlier and I am glad to repeat, that we had found through experience that covenants were worthless and the main thing was to simply make sure that it was the owner of the property who was making the loan to you, and you relied entirely on the property.

Now, if you could get a lease—a leased property, then you relied on the lease. This was a different proposition, the lease is the best security you can get from a good company, but as far as owners are concerned, rarely would you get developers of any substance letting you get at their substantial company. If they were going to lend to you, they would set up a new company so they would protect themselves and you just had to rely on what you were taking as a security.

Q. Did you commonly require guarantees from other persons, collateral from other persons of substance?

A. Not commonly.

Q. This was a mortgage on vacant land, were your rules any more stringent for such mortgages?

A. No.

Q. They were the same as your rules in respect to mortgages on which there were structures?

A. That is right. We would if there was—you know—improved land or vacant land, we would require valuations and more land and so on. This we would require on some of the equity to give us the—to help compensate for the risk and we certainly tried to make sure that we got all the security we needed and naturally, we did very well in this type of loan.”

The financial statement of Conarm as at January 31, 1964 prepared by Armstrong, Cross & Co., chartered accountants in Ottawa, which Gregory maintained that he never saw but which was presented to shareholders on March 20, 1964, almost four months before his meeting with Connelly, shows “Long Term Notes Payable—Aurora Leasing Corporation Limited 10%—\$802,533.75”. It is inconceivable that the inquiries of British Mortgage & Trust which Gregory refers to should not have included a request for production of this statement, which incidentally provided information of a net loss for the period of \$198,455.76 and a deficit of \$193,455.76;⁷ it is equally so that Cuzner, who said that Morgan was spokesman for the group at the meeting and himself made the offer of 10% of the equity of Conarm, should be wrong or untruthful on this point, and that Gregory was not aware of Morgan’s personal interest in Conarm. In this connection it should be observed that Cuzner

⁷Exhibit 1964.

held his 2,999 common shares in trust for Morgan who, on June 22, 1965, sent him the following memorandum:⁸

"As advised at a previous date verbally through Mr. Della Scala, this is to confirm my request to have my shares transferred into the name of Mr. Della Scala who will look after my interest in our venture.

This transfer will cancel the trust agreement which I am advised exists between yourself and myself. I cannot lay my hands on it presently.

Thank you, Best Regards.

'C. P. Morgan' "

To this was added a note from Della Scala:

"This should not & does not include the qualifying share." Thus, nearly a year later, Morgan's obligation to British Mortgage & Trust had apparently passed from his mind.

M. Della Scala and the Trustee

Looking again at the shareholders set out on page 1216 it may be noted that Della Scala understood from the beginning that Harry Wagman's 3,000 common shares were held for Aurora and that the 2,999 held by Cuzner in trust for Morgan were required for further financing. He could not explain why the Wagman shares were paid for out of the Trio account, or why they were not registered in Aurora's name. He maintained that his own 10% interest was reluctantly acquired, since he only intended in the first place to do Morgan and Connelly a favour by bringing them together; Morgan however insisted that Della Scala should be interested in the project. The issue of 30,000 preference shares on December 22, 1964 seems to have preserved the original ratio of distribution of the common shares, except that Morgan held 9,000 as registered owner and a further 9,000 was divided between him as to 6,000 and Harry Wagman as to 3,000, held in trust; if Aurora Leasing was the beneficiary this was not disclosed. That it evidently was not may be deduced from the fact that on May 12, 1965 all 18,000 of these shares were transferred to a Trio company, Chartered Management Consultants. After the collapse of Atlantic, Della Scala, unwearied of well-doing, discussed the future of Conarm with W. A. Farlinger of the Clarkson Company Limited, receiver for Aurora Leasing, and stated his view that Conarm would eventually make a substantial profit if additional funds, in the order of \$650,000, were provided over the next two or three years. Farlinger undertook to consider this favourably if Conarm provided security for its debt to Aurora, and this was done, as it should have been done in the first place, by an issue of debentures. Della Scala then set out to acquire all the common shares not owned by himself and Connelly and Morgan co-operated to the extent already shown by send-

⁸Exhibit 1958.

ing his memorandum of June 22, 1965 to Cuzner. Harry Wagman was more tenacious. He agreed to transfer 20,000 shares to Della Scala and, as to the remaining 1,000, left a "receipt" in his office for Della Scala to sign and which he was not there to discuss. It read as follows:¹

"ACKNOWLEDGMENT OF TRUST"

The undersigned hereby acknowledges receipt of certificate number eleven (11) representing one thousand (1000) common shares in the capital stock of Conarm Developments Limited registered in the share register of Conarm Developments Limited in the name of Harry Wagman, which shares have been delivered to the undersigned in trust on the following conditions:

- (a) a formal trust agreement respecting the said shares in a form satisfactory to the said Harry Wagman shall be executed by the undersigned on or before the 5th day of August A.D. 1965:
- (b) it is acknowledged that the said shares represent ten per cent (10%) of the issued and outstanding, fully paid, common shares in the capital stock of Conarm Developments Limited, and it is agreed that the said ten per cent (10%) interest shall not be diluted by the issuing of additional shares in Conarm Developments Limited prior to the execution of the trust agreement aforesaid:
- (c) in consideration of the appointment of the undersigned as Attorney for the said Harry Wagman to transfer the said shares in the books of record of Conarm Developments Limited, the undersigned acknowledges that the said shares and all benefit and interest accrued and/or accruing thereunder are, and shall be, held in trust for the benefit of the said Harry Wagman.

DATED at Toronto, Ontario this 29th day of July A.D. 1965.

"

Della Scala signed this after adding the words "subject to the agreement between Conarm, Commodore, M. Della Scala & W. G. Connelly". This attempt by Wagman to obtain a beneficial interest in 10% of the Conarm common shares was facilitated by the fact that the original 3,000 were issued in three separate certificates of 1,000 shares each, according to precise instructions given to Cuzner by C. P. Morgan; it is therefore doubtful that they ever were intended to be beneficially owned by Aurora Leasing. In any event Della Scala got all of the shares, amounting to 70% of the equity, under his control and he and Connelly deposited them with the Montreal Trust Company, pursuant to their agreement with the Clarkson Company. Della Scala said that he had told Morgan that he would consider himself as a trustee for Morgan's 30%, 10% of which were "involved in a problem with Victoria and Grey

¹Exhibit 1957.

Trust", as well they might be in view of Morgan's instructions to Cuzner of June 22, 1965.

Conarm Developments, with a contributed capital of only \$35,000 but with assets in the form of land valued in the summer of 1963, optimistically, at some \$6,000,000,² had borrowed, by the date of the collapse of Atlantic, \$1,345,000 from Aurora Leasing Corporation on no security and \$500,000 from British Mortgage & Trust, secured by a mortgage with various and declining priorities. The receiver and manager of Atlantic Acceptance Corporation, guided by the Clarkson Company, shared Mastino Della Scala's confidence in Connelly and his enterprise and in its "Memorandum as to Initial Award of Compensation", presented to the Supreme Court of Ontario,³ included Conarm in a class of debtor with the Lucayan Beach complex and the Treasure Island group, "where it was felt that a much greater recovery could eventually be made if substantial additional financing was made available to the companies involved to permit them to carry on business". The memorandum added: "In the case of the Lucayan Beach complex and Conarm it has been necessary to advance substantial additional funds to permit the business to carry on." In the Clarkson Company's review of loans, also lodged with the court,⁴ it was estimated at March 31, 1966 that some \$600,000 was required as "an additional minimum investment" and the review concluded: "We could recover nothing on the subject if we abandon it at this time. It is possible we could recover our original investment or substantially more if we keep the project." Progress in the sale of lots has, however, been slow and, in spite of the possibility of a satisfactory liquidation of this venture of Morgan's with Atlantic money, the position of British Mortgage & Trust Company and its successor must remain unenviable because of the readiness of its former management to take security which a reasonably competent examination would have revealed as likely to be exhausted before the loan was fully repaid.

Aurora Leasing Corporation: Loan to W. P. Gregory

It has been seen in Chapter V¹ that Wilfrid Gregory's profit from the acquisition of the interest of the minority shareholders in Commodore Sales Acceptance by Atlantic Acceptance Corporation, at a time when he was a director of both companies, amounted to \$21,480² and the convenience of being able to borrow a large sum from Commodore Sales Acceptance, without giving security, in order to finance the purchase of the Owen Sound I.G.A. store has already been illustrated. He was to rely on this company, and Aurora Leasing Corporation which

²Exhibit 1955.

³Exhibit 4715.

⁴Exhibit 5124.

¹p. 133.

²Exhibit 3266.

borrowed all its funds from it, to secure his commanding position as a shareholder of British Mortgage & Trust Company and to create his fortune. On June 15, 1961 he borrowed \$215,000 from Commodore Sales Acceptance to pay for 1,000 shares of the old stock of British Mortgage & Trust on which he had an option given to him in 1957, as already seen, good until the end of 1966. At this time the stock was trading on the unlisted market at \$300 per share.³ On December 13 of the same year he purchased a further 1,000 shares at \$300 per share in the exercise of a further option, the current trading being at a price of some \$335 per share. The funds for this purchase were provided by Aurora Leasing and in both cases the stock was lodged as security. Thereupon Commodore Sales Acceptance, by journal entry, transferred its loan of \$215,000 to Aurora Leasing to which it was lending at a rate of 10% per annum. A further advance was made to Gregory of \$10,000 on May 1, 1962 by cheque payable to him, rather than to purchase anonymous drafts in favour of British Mortgage & Trust as in the two previous instances, and the use made of this loan has not been ascertained. The loan, therefore, by this date had reached the very large sum of \$525,000 for which Gregory was charged interest at 6% per annum by a company in which British Mortgage & Trust held an interest of 20% and which was paying Commodore Sales Acceptance 10% for the funds. On April 1, 1963 the loan was repaid in one sum by the Toronto branch of the Canadian Imperial Bank of Commerce in the amount of \$530,000, representing the principal amount plus interest of \$5,000, and as a result of a loan negotiated there by Gregory. At this point he wrote the following letter, dated March 21, 1963, to Harry Wagman:⁴

"Dear Harry:

Re: Personal Loan with Aurora

As I mentioned to you over the phone, I have arranged for the Canadian Imperial Bank of Commerce to credit Aurora with \$530,000 upon delivery by you to them of Certificates 0253-4-5-6 totalling 40,000 shares of British Mortgage & Trust Company. These shares should be delivered to Mr. G. M. Parkinson, an Assistant Manager at the Head Office of the Canadian Imperial Bank of Commerce, on Monday, April 1st.

My computation of the interest owing to April 1st on \$525,000 at 6% from December 31st is \$7,853.42. I am enclosing herewith my cheque for \$2,856.27 which will complete the payment to you, plus exchange of \$2.85.

After the loan has been paid you might send me back a note and any other papers you have in connection with the loan. May I thank you very much for your consideration in extending this loan to me over the past year and a half.

Yours very truly,
'Wilf Gregory'

³Exhibit 4337.

⁴Exhibit 1637.1.

Over the period of this loan Gregory paid interest of \$47,161 and Commodore Sales Acceptance charged Aurora Leasing \$67,630, so that Aurora lost \$20,469 on the investment. The loss might have been some \$8,000 greater had Commodore Sales Acceptance charged its customary 10% rate to Aurora Leasing for the period June 15 to December 13, 1961, before the journal entry transfer to Aurora was made. The transaction was put to Gregory by counsel, and he was asked if that was substantially what had occurred and if he wished to see the documents relating to it in the possession of the Commission.⁵

"A. Oh, no; I think that is what occurred, except for, if I may, amplify it in one or two respects. First of all, as far as I was concerned I was borrowing the money from Atlantic, although it didn't turn out that way. I went to ask Powell Morgan one day after the meeting. I said, 'Are you at all interested in lending me money at 6 per cent?' The money market was quiet just then and Atlantic had money in hand because they had just made a financing issue. And he said, 'I might be; tell me more about it?' And I said it was to take up an option with British Mortgage. And I said I have five years to take this up and I don't need the money and I can't pay more than 6 per cent because it is not worth my while. For tax purposes your benefit is lower if you buy the stock cheaper, for the option price; and that is the reason I wanted to do it and that is the reason I put it to him in this way. I don't know where the money came from and what subsidiary to start with. You say it was Commodore Sales; fine. That fall I went to him and had a chance to get another thousand allotted to me when another option plan was being done and asked him if he would like to lend a further sum, and he said 'Fine'. Then, when he produced the note for me to sign it was made out to Aurora and I commented on it and I said why was it made out to Aurora and he said, 'Just for internal convenience'. Well, I didn't think anything of it; maybe I should have.

Q. The difficulty we have, Mr. Gregory,—

A. May I just finish that? Then, we went along and after he came along in January, 1963, and wanted to borrow some money from me for Aurora. I thought I had better pay off my loan to Aurora if they need money and I went to the Bank of Commerce, the next time I was in Toronto, I didn't want to do it in Stratford, and paid it off, borrowing the money there at 5¾ per cent, one-quarter per cent less, and I think it was in March. Anyway, it doesn't matter. But, I could have paid that loan off earlier if I had been requested to at any time.

Q. On the 15th of December, 1961, when Aurora loaned you the \$515,000 at 6 per cent it borrowed that money from Commodore Sales Acceptance at 10 per cent. The loan remaining outstanding for 15 months at a differential of 4 per cent the cost to Aurora was something in the order of \$25,000. Were you aware of where Aurora was getting the money to loan you?

⁵Evidence Volume 115, pp. 15640-5.

A. I was not aware of that and I was not aware of the interest rate or I wouldn't have permitted it because Aurora was lending the other—Aurora was borrowing money at 7 per cent from—

Q. On its note?

A. From Atlantic, even on other loans. I don't know why this particular one was put through at some different rate.

Q. I do not think Aurora was borrowing very much money from Atlantic at 7 per cent, Mr. Gregory; but Aurora was borrowing on its notes. It had sold \$600,000 worth of notes at 7 per cent. It is perhaps to that that you refer?

A. But Atlantic was also lending money at 6 and 7 per cent and my original deal was with Atlantic, with Mr. Morgan, the president of Atlantic, and this is all I was concerned about.

Q. As a director of Atlantic with which you were concerned in 1961, you would be aware of the interest rate, and on their senior secured notes they were paying $5\frac{3}{4}$ and 6 per cent. Were you aware of that?

A. I must have been aware of what they were borrowing on the notes. Senior secured notes?

Q. Yes?

A. They were borrowing on the money market at $3\frac{1}{2}$ and 4 per cent.

Q. $4\frac{1}{2}$. You are speaking now of the overnight loans and demand loans?

A. They were borrowing regularly in the money market, millions of dollars, at $3\frac{1}{2}$ and 4 per cent.

Q. The senior secured notes covered by the indenture of trust, sold to a variety of purchasers and paying more than the short term notes, which were on demand or outstanding for a few days, they were being borrowed at $5\frac{3}{4}$ or 6 per cent?

A. If you say so.

Q. Did you consider you were getting a benefit, first, from Atlantic in being able to borrow 100 per cent of a purchase price at that rate of interest?

A. 100 per cent of the purchase price?

Q. Of the British Mortgage shares?

A. Just a minute. The percentage of the price I borrowed was about two-thirds of the market value, which I think is important; and I didn't think I was getting a benefit for the reasons, first of all, I wanted to do business with Atlantic if I could. I always tried to support any company I was a director of, I offered it to Mr. Morgan. I made it quite clear that he did not need to make the loan, I wouldn't even worry about it. If he had this extra money available, which he mentioned having right then and he wanted to put it out at that rate, which was their wholesale rate, their best rate they lend, if they wanted to do that I would be glad to have it.

Q. What other persons were borrowing from Atlantic at 6 per cent?

A. I don't know.

Q. Why do you say they were lending to other people at that rate?

A. That was their prime, their wholesale rate, that was the rate they would lend to car dealers and other types of persons.

Q. Would that not be on an interest included loan where the interest is added to the principal originally and the true rate of interest is double their stated rate?

A. No, I don't think so, not the wholesale rate basis. What I was told, the wholesale rate was 6 per cent. So, I asked him not only for their best rate, sure, I asked for their best rate, but I said, 'Are you interested in lending it to me at that rate?' I could have gone to a bank and dealt with them, or an investment dealer, at 6½ per cent. If he didn't want to lend it to me all he had to say was no.

Q. Can you suggest any reason why he said yes? Why did he lend you this money at 6 per cent?

A. Because he had it.

Q. And wanted to get it out at 6 per cent simple interest?

A. When you have money on hand after a financing, or something, you are putting it out anywhere you can to cover your costs. We ran through this a great deal of time."

The loss to Aurora in this situation, insignificant in its final plight though it may have been, was nevertheless a loss to its shareholders of which British Mortgage & Trust Company was the largest. Even at 6% per annum the cost of such a large loan to Gregory was heavy. British Mortgage & Trust had paid a basic dividend of \$8 per share from 1934 to January 2, 1963 when the old stock was split. An extra dividend of \$3 per share was paid in 1960 and \$4 in 1961. In 1962 this was also paid and, in addition, on Gregory's recommendation to the board of directors, "a special bonus of \$2 to celebrate the opening of our new Head Office".⁶ Thus he would have received over the life of the Aurora loan, since the dividends were paid in the first week of January, \$52,000 by the end of 1962, the dividend for 1961 being paid to shareholders of record at December 15, or two days after his second purchase of 1,000 shares had been made. At the new quarterly rate of 15¢ per share, paid in April 1963 on some 40,000 new shares, his holdings of British Mortgage & Trust stock would have yielded an additional \$6,000, and taxes on all this increment were subject to deduction of interest paid on the loan and a 20% dividend tax-free allowance on the residue subject to tax. It has been seen that the dividend rate continued to rise to a regular quarterly rate of 25¢ per share, provided for in January 1965 in spite

⁶Exhibit 4281.

of a decline in real earnings and in the value of the stock which, however, under the impact of Gregory's dividend policy, had reached the highest level in its history by the end of 1963. Finally, Gregory's observation that he could have, at any time, borrowed from a bank, or from an investment dealer, on equally advantageous terms ignores the fact that the price of British Mortgage shares in 1961 would not have made the second loan of \$300,000 attractive to the former, or fulfilled the margin requirements of the latter, and must be considered specious.

W. P. Gregory and his Board

A word must be said about the extent to which the other directors of British Mortgage & Trust were familiar with the company's business generally, and with the activities of the managing director in particular. John R. Anderson gave a description of the conduct of meetings of the board of directors, and of its executive committee, with which the other directors examined broadly agreed. Drawing on his experience as a director since 1955, he considered that W. H. Gregory had, at least up until 1965, played a more active and decisive part in the affairs of the trust company than Wilfrid Gregory indicated in his own evidence. "He presided," said Anderson, "with resolution and obviously seemed to us very familiar with the affairs of the company" and "took an active part in consultation on all management matters". Anderson was a member of the executive committee from its creation in 1959 and described its meetings as follows:¹

"Q. How often did the committee meet?

A. Once a week.

Q. On the average, and I appreciate the difficulty of stating an average, what would be the duration of these meetings in time?

A. I would say an hour, approximately, more especially in later years as there were more mortgage applications to be dealt with. I am sorry, I should refine that by saying, on the fourth Tuesday of the month, when the board of directors met right after the executive committee, the executive committee meetings were usually of shorter duration.

Q. Did the members of the executive committee get an agenda in advance?

A. No, they did not.

Q. Did they get an agenda at all?

A. Yes, there was one at our place as we came in to be seated.

Q. What was done with the agenda?

A. It was gathered up afterwards and we didn't see it again.

¹Evidence Volume 117, pp. 15998-16001.

Q. Did members of the committee get minutes?

A. No.

Q. Were those minutes read at these meetings?

A. In very skeleton form.

Q. Would it be fair to say it was a summary of the minutes?

A. A very brief summary. If you wish me to elaborate on that, it would be there were fourteen mortgage applications approved, eight items of investment and finance approved, five trust and agency matters dealt with. And then, if there were any special things, such as a new decision to open a new branch office in Newmarket, say, that would be extended a little more in the reading.

THE COMMISSIONER: Mr. Anderson, before we leave this question of the agenda, which has been put to witnesses before you, also, was there some understanding that the agenda should not be taken out of the room, or was it simply a custom you didn't take it out?

A. Mr. Commissioner, it was simply a custom. There was no verbal understanding on the subject. But I think to answer that fully I should tell you that I myself wondered about it at times, but thought it was related to the fact that it had been stressed to us very frequently, and it was stressed to me when I came on the board, first of all, our meeting was a very highly confidential thing because we were dealing with the financial situation of various people in the community, among other things, and we pledged an oath of secrecy at the beginning of each new year of the board of directors. And I always considered it a policy that existed when I went to the board and continued throughout, a policy of gathering up the agenda or not seeing it again, was related to that.

THE COMMISSIONER: Thank you.

MR. SHEPHERD: Thank you.

Q. Who was this person who gave you the summary of the previous meeting?

A. Mr. Pike, the assistant secretary.

Q. What did he have in front of him when he gave it?

A. Oh, he had the minute book. He had the minute book because the chairman of the board signed the minutes in our presence after that was given."

Counsel then turned to the subject of applications for mortgage loans and the extent to which these were scrutinized by members of the executive committee, particularly in view of the fact that many of the application forms examined by the Commission contained very little information and some were virtually blank.²

²Evidence Volume 117, pp. 16002-5.

“Q. Was one of the functions of the executive committee to approve applications for mortgage loans?

A. Yes.

Q. How was this done?

A. The application, naming the mortgagor, briefly the security, such as two hundred and thirty on a certain street, and the amount of the mortgage was on this agenda with which we were furnished.

Q. Yes?

A. And the application forms were kept up at the head table where sat the chairman of the board and Mr. W. P. Gregory, the managing director and later president, and Mr. Pike. Mr. W. P. Gregory would read these applications for him. And I don't mean in full or verbatim, but summarized them, gave us the meat of them. This prevailed until I would think about 1963 when Mr. Pike then read them. But, in any event, Mr. Gregory read them at the beginning and Mr. Pike read them later. But all three were present.

Q. Was it the practice to deal with all the mortgages one after the other and then have them all proved, or was there an approval recorded for each specific reference?

A. An approval for each specific reference, I would say. I don't remember that, sir, not being a formal motion, but simply we had gone through that, 'and is that approved?'

Q. Yes?

A. Yes. We would pass on to the next.

Q. Do you recall during your years on the board and on the executive committee of any occasion on which a mortgage put forward by W. P. Gregory or other of the officers for approval was not approved by the executive committee?

A. I don't recall any in which they made the unequivocal recommendation this was a good mortgage, a good investment. But I do recall, not frequently, but not too infrequently, that there would be a mortgage application as to which they were not certain whether they recommended it or not, and wished to discuss it with us. And we would discuss that at some length, and in some cases approved and in some other cases not approve. I can't name specific matters now, but that did happen.

Q. Is it fair to say that the experience was that if Mr. Gregory, W.P., formally recommended the approval of a mortgage, it was approved, but if he expressed some uncertainty about it, it might be approved or not be approved after discussion?

A. I think that is a fair summary of the position.

Q. There is evidence before this Commission indicating that the company followed the practice of having the members of the executive com-

mittee—yes, all the members of the executive committee initial mortgage application forms. How was this done in a physical sense?

A. Right. At the end of the meeting, after adjournment, the mortgage application forms, which were at the head table, were folded to the size and shape, say, of an envelope, and were circulated to the members of the committee. And we put them in a pile and circulated and initialled. All we saw at that stage was the outside of the form on which one, I believe, was typed the mortgage number and the name of the borrower and the amount. I think the interest rate was there.

Q. There would be occasions, would there not, when there would be as many as twenty-five or thirty of these?

A. Yes.

Q. And they would be passed around in a pile, I suppose, and everyone would initial them?

A. That is right. But sometimes the pile was divided in two, and half was circulated at this side of the room, and the other at this, and reversed.

Q. Occasions have come to the attention of the Commission where initials of directors appeared on the reverse side of the mortgage form and the face is a blank. Can you assist us whether directors were aware they were initialling blank mortgage forms?

A. I certainly can assist you. We were not. We never at any time knowingly initialled a blank mortgage form."

Counsel then referred to the part played by the executive committee in making investments, particularly in relation to the knowledge of the directors about investments in and loans to Aurora Leasing Corporation.³

"Q. Turning to the question of investments, how generally were they handled at the executive committee and who was the person who handled them?

A. The making of investments was left entirely to the general manager and president, Mr. W. P. Gregory. Again, as we presumed, working under the surveillance and with the cooperation of his father, although to be fair on that I felt it was Mr. W. P. Gregory who made the decisions, but that Mr. W. H. Gregory knew of those decisions.

Q. Yes?

A. At a very early stage in my time on the board I remember it being stated that the management had to have authority to make purchases and sales on the spot, that it couldn't await meetings of a group to discuss them, decisions had to be made right over the telephone or in response to a letter as market conditions varied, and this authority was given, but they were to be reported to the board or to the executive committee, and this was the practice.

³Evidence Volume 117, pp. 16037-40.

Q. How would Mr. W. P. Gregory discuss the investments which he had made with the board?

A. Well now, that varied a lot. The investments were set out on this agenda with which we were furnished. First there would be purchases and certain things would be listed, including, for instance, short-term notes of Atlantic and later on, of Aurora and so on, and then there would be sales. And there were a lot of purchases and sales altogether other than Atlantic and the others we have been hearing about, other companies. He reported this, he showed this. He didn't as a rule go into any extensive detail but he did on some occasions. For instance, when first Aurora arose he discussed that with us, telling us he had done it and telling us his reasons for having done it.

Q. Yes?

A. I remember that Aurora was said to be the Canadian subsidiary of a very successful American equipment leasing company. It was being taken over by Canadian interests. It already had been very successful and showed great promise for the future and was highly recommended and that as an investment it was felt we should take a 20% interest in it, which was our limit under the Act.

The impression I got from what he said at that time, and carried throughout, was that it was in the business of leasing factory equipment, office equipment and things of that sort.

Q. During the course of this discussion in 1960, did Mr. Gregory also remark that he himself was going to take some interest?

A. Yes, I believe he did. He did at some stage. I knew he had some shares of Aurora Leasing. I am sure he did.

Q. Did you know the size of his investment from time to time?

A. No.

Q. Do you recall whether the fact that he was a shareholder of that company was ever alluded to again?

A. No, I think not after the original allusion.

Q. So then, I take it your evidence is consistent enough with the evidence of Mr. Ireland that the remark of Mr. Gregory to which you have alluded was made in the executive committee and therefore presumably would not come to the notice of Mr. Ireland?

A. I quite agree.

Q. You were aware, I suppose, from time to time that British Mortgage was doing what is described as purchasing short-term notes from Aurora; is that correct?

A. Of Aurora, yes.

Q. Of Aurora, yes.

A. Yes.

Q. And, insofar as you have an opinion on the matter, what was your view as to what the type of security was that you were getting?

A. I thought it was a pledge of accounts receivable from its leasing contracts or probably its leasing contracts. I do remember that it was very definitely stated that these notes were all secured to the extent of 125% of value. To the best of my recollection, I think a trust company was mentioned as the trustee for that security.

Q. Mentioned by whom?

A. By Mr. W. P. Gregory, but I am sure it was not an individual lawyer.

Q. I take it then you were not aware that insofar as there was any security, and that wasn't very far, that Mr. Carl Solomon was the trustee for British Mortgage?

A. I was not aware of that."

The subject was raised again at a later stage of the examination in connection with the renewal of Aurora notes which Anderson and the other directors believed to be secured:⁴

"Q. What report did Mr. Gregory make from time to time, if any, on the progress of Aurora Leasing Corporation Limited?

A. Well, I don't recall any reports on progress. There was the conversation which I think I have related in evidence.

Q. Yes.

A. Here today. At the outset of our investment with it. And it was implicit of course in the fact that he continued to take notes or renew notes of Aurora Leasing that it, in his opinion, was progressing well, and favourably, but I don't remember progress reports.

Q. On that point of renewing notes, British Mortgage & Trust made loans usually in the amount of \$250,000 to Aurora on what were called short-term notes. That is, that was the designation given to the directors. And the company followed the practice, when those notes fell due, of renewing them, that is to say, lending the money all over again. The minutes of the executive committee do not indicate that management ever again had its acts respecting Aurora renewals ratified by the executive committee, but acted on the principle that the executive committee having approved the original loan for 90 days perhaps, must be taken to approve any series of subsequent renewals. Now, are the minutes correct in this or were these renewals discussed from time to time?

A. No, I don't recall renewals being discussed. When I spoke of renewals a moment ago, what I had in mind was this, you must remember we never saw the thing in cross-section except at October 31st.

Q. Yes?

A. If you took a short-term note of \$250,000 for, say, three months.

⁴Evidence Volume 117, pp. 16053-4.

Q. Yes?

A. And subsequently, maybe three months later, but you didn't keep track of this, maybe six months later you took another short-term note of \$250,000, we assumed that the first note had been paid when due and that any note or security that was not paid when due would be immediately reported to us."

The extent to which the directors of British Mortgage & Trust were aware of particular transactions, such as the loan to "Lucayan Holding Limited" of \$1,200,000 and the loan of the same amount to Aurora Leasing on the security of shares of Camerina Petroleum, and the effect of the change of accounting for income from a cash to an accrual basis for the year ended October 31, 1964, has already been discussed. The consensus of their evidence was that they had either not been informed, as in the case of the loans, or had been misinformed, as in the case of the accounting change. The directors who were not members of the executive committee, Brigadier Lind and Messrs. Ireland and Lawson, said that information as to the transactions of the executive committee was either not given at all or a brief verbal synopsis would be occasionally offered by Wilfrid Gregory to the meetings of the board. These directors did not have copies of either the agenda or minutes of the executive committee, but only an abbreviated report of the loans approved when it was necessary for the board to ratify the granting of mortgage and other loans. On these occasions only the briefest details were given, ratification was in effect automatic and the reports surrendered after the meeting. Lawson's description of the first meeting of the board which he attended in 1965 may be regarded as typical of the procedure.⁵

"Q. On the occasion of the first meeting which you attended back in January, could you assist the Commission by stating your recollection of how the meeting was conducted, what manner of discussion there was, and the like information?

A. The meeting was held in the board room of the British Mortgage Company in Stratford. The other directors were already there when I got there at whatever time it was called. It may have been called for eleven o'clock. I found that they were there because they were all on the executive committee. Brigadier Lind from St. Mary's was not there, but to the best of my recollection all the other directors were there, but I had not previously met any—well, that's not quite correct—I had previously met Mr. Armstrong.

Q. Yes?

A. But I had not previously met Mr. Gregory, Senior, or any of the other directors; and Mr. Gregory Senior was in the chair. Mr. Wilfrid Gregory was at his right side, I think, and Mr. Pike was at his left side. Mr. Gregory Senior conducted the meeting. He obviously showed his

⁵Evidence Volume 119, pp. 16144-6.

experience and ability at conducting meetings and did it with proper dispatch. And they—my recollection is that the first, or almost the first item of business, after reading the minutes—I wouldn't say the minutes were read, they were at least adopted, but then there was a report of the executive committee and that report was already written out much in the form of minutes. I frankly don't remember whether it was read at the meeting or simply adopted as read. But there was certainly a copy in front of each director, and my copy was there.

Following that, I can remember the president, Mr. Wilfrid Gregory, making some comments; it may have been under the heading of the President's report, but I don't remember for certain. His comments, I think, had to do with the money situation at the time and some of the arrangements the company was making to lend on mortgages, and so on. Then, at some stage, Mr. Armstrong, who was assistant general manager of the company and in charge of estates and trusts, went over the various changes in the investment portfolio that had occurred in these estates and trusts, and each one was approved. There was also some point where Mr. Pike made a report on mortgage operations, with particular reference, I believe, to the mortgages that were—that had been paid off because discharges had to be approved one by one by the board. For the moment, that's all that I can remember, sir."

When Brigadier Lind was asked if there was any occasion on which any director or officer of the company declared an interest in a transaction with which British Mortgage & Trust Company was concerned in his experience as a member of the board, he answered "no".⁶ Mr. Ireland's evidence on this point was as follows:⁷

"Q. Do you recall any occasion upon which any officer of the company, or indeed any director, declared his interest in any transaction to which the company was a party?

A. None whatever.

Q. To be specific, were you, and I appreciate you were not a member of the executive committee, were you aware that Wilfrid Gregory personally had an interest in Aurora Leasing Corporation?

A. No.

Q. Were you aware from any source, prior to the collapse of Atlantic, that Mr. Gregory Junior had an interest in N.G.K. Investments Limited?

A. I personally never heard of that particular company.

Q. I don't wish to go through a list of them. Perhaps I could ask one general question. Were you aware of any instance prior to the collapse of Atlantic in which Mr. Gregory, Wilfrid P. Gregory, had an interest in a company or a transaction to which British Mortgage & Trust was also a party?

⁶Evidence Volume 117.

⁷Evidence Volume 117, pp. 15971-2.

A. Only to the effect that he was a director on various of these companies.

Q. Referring to him being a director of Atlantic Acceptance and a director of Commodore Business Machines?

A. Yes.

Q. Apart from that?

A. Nothing."

As already seen, Anderson recalled that Wilfrid Gregory had mentioned, either to the board or to the executive committee, his own interest in shares of Aurora Leasing Corporation, and Anderson also testified about the information he had passed along to Armstrong of Pike's apparent interest in the West Lorne mortgage transaction. He was asked additional questions on this subject in relation to mortgage investments, introduced by a question on the subject of independent valuations of properties to be taken as security for the trust company's mortgage loans.⁸

"MR. SHEPHERD: Dealing with the matter of valuation, the mortgage files indicate that in the earlier years, and by this I mean, perhaps, 1961, that large mortgages, say, over a quarter of a million dollars, the company did on frequent occasions obtain independent valuations. In later years, however, say, after about 1962, the company appears almost invariably to have followed the practice of using the valuation of its own employees, using, say, Mr. Pike or Mr. Facey only. Do you recall whether there was any discussion as to what the company's policy should be on this matter?

A. No, sir, I recall no discussion of policy on that matter. My own recollection is that circumstances were such as you just related. I think we all felt that Mr. Pike, who then had been head of the mortgage department for, what, twelve, fifteen years, perhaps, and Mr. Facey, who had been with us of the order of ten years, and both of whom we had complete confidence as to ability and integrity, that these valuations were very adequate and as good as we could get.

Q. Do you recall any occasion before the executive committee, and I am dealing now with mortgages only—

A. Yes.

Q. —where any officer of the company or director had occasion to declare his interest in the affairs of a borrower from British Mortgage against mortgage security?

A. No, I do not, sir."

After J. M. Armstrong had given his evidence about the purchase of the West Lorne I.G.A. store for the Gaffney pension fund and had said that

⁸Evidence Volume 117, pp. 16006-7.

he had no knowledge of Gregory's participation, the following questions were put to him:⁹

"Q. Do you recall any occasion either at the executive committee or at the meeting of the board of directors at which Mr. Gregory, or, indeed, anyone, being a director, declared any interest in any transaction with which British Mortgage & Trust were concerned?

A. No, I did not, sir.

O. And to be specific, I am sure your general answer covers it, I take it you knew nothing of Mr. Gregory's interest in a company called Promenade Swiss, a mortgage borrower; a company called Yonge-Eglinton Building Company, a mortgage borrower; Dale Estate, a mortgage borrower; or Indiancrest Limited?

A. No, sir."

Similarly Dr. Kenner, a member of the executive committee, denied that he had ever heard Wilfrid Gregory at a meeting declare his interest in anything and said that his general statement to that effect covered I.G.A. stores, Yonge-Eglinton Building Limited, Promenade-Swiss, The Dale Estate and Indiancrest. Indiancrest Limited, only referred to incidentally hitherto, was a company incorporated to develop vacant land as a sub-division near Chatham, Ontario, valued at \$111,000 and was in receipt of a mortgage loan from British Mortgage & Trust Company of \$250,000 to enable it to install services after the land had been subdivided into lots. As an inducement to make the loan the trust company was offered 20% of the common shares of the company, amounting to 20,000 shares, for which it paid \$700, and at the same time Wilfrid P. Gregory, Q.C. and W. A. Pike received 5,000 shares each for which they paid \$150.¹⁰ After encountering considerable difficulties with contractors the company made a settlement which enabled it to pay off its mortgage in September 1962. There is no evidence before the Commission as to disposal of the shareholdings of British Mortgage & Trust, or of its president and mortgage manager. Their conduct in making personal investments in companies to which British Mortgage & Trust lent money, sometimes in conjunction with an investment by the trust company itself, sometimes, as has been seen in the case of Frederick's Department Store,¹¹ in a company which was borrowing from companies such as N.G.K. Investments and Aurora Leasing Corporation in which both British Mortgage & Trust and its president had an interest, or in companies which were mortgage borrowers from the trust company like Promenade-Swiss and Yonge-Eglinton Building, without making any disclosure to their board of directors, was the subject of comment by Gregory himself when he testified before

⁹Evidence Volume 117, pp. 16096-7.

¹⁰Exhibits 4583.10 and 4596.

¹¹pp. 259-64.

the Commission. His views emerged in their clearest form when asked by counsel about the knowledge of the directors of his position in N.G.K. Investments and Aurora Leasing Corporation.¹²

“Q. Mr. Gregory, when British Mortgage and Trust made their investment in N.G.K. Investments Limited, did the directors of the company know of your personal holdings in N.G.K.?”

A. Well, as I say, they knew about them at the beginning. I don’t know that—let us see—when we paid the loan you mean for the purchase of the Commodore shares?

Q. No. I mean when N.G.K. was incorporated and British Mortgage and Trust took down some notes and shares and you took down some notes and shares?

A. Oh, yes, because this was all part of the same transaction with Aurora and N.G.K., that was mentioned at that time, and I was . . .

Q. And your interest was disclosed to the directors at a meeting?

A. That is correct.

Q. Can you assist us as to why the disclosure is not recorded in the minutes?

A. ’Twasn’t that important. It was treated just as almost a discussion. Our minutes only kept track of decisions made and you see, this wasn’t—the fact that they may be—I should emphasize this—the fact that they had an interest and I was buying an interest I disclosed it most casually because I was in supporting their interest. They could only get 20 per cent. I could have more and in this way the investment was better for them, because I strengthened the mutual position by being in there together.

Q. Do you mean in the sense that you would better be able to look after the matter?

A. 30 per cent is what the federal people, the Federal Trust Company, can have 30 per cent of a subsidiary. The provincial companies can only have 20 per cent, and I always thought this was a weakness because in a minority interest in a company 20 per cent is very little. It is amazing how much more even 30 per cent could do. Get to a third because maybe one other person—and you can have some influence and we were just getting into that position in Aurora where we were going to have a battle. In N.G.K. we didn’t know it, but we should have been there too, but anyway my buying some shares along with the company was supporting our mutual interest, was exactly the same interest.”

As to his interest in Aurora Leasing, the witness did not claim to have made the disclosure which Anderson recalled him making. The explanation for this may be that the matter was raised in a meeting of the execu-

¹²Evidence Volume 115, pp. 15694-6.

tive committee and not stated to the board as such; it may be that Anderson was mistaken and that he, as a close friend and former colleague, may have learned of it in the course of private discussion; again it may be found in the nature of the first question which counsel put to Gregory linking Aurora with Atlantic.¹³

“Q. Did you inform the directors of Atlantic that you had an interest in Aurora and that Aurora was borrowing a large sum from Atlantic?

A. On what occasion?

Q. Did you inform your fellow directors of Atlantic Acceptance, that you had an interest in Aurora which was a substantial borrower from Atlantic?

A. I don't expect so. I don't think it ever came up.

Q. Did you consider yourself under any obligation so to do?

A. I never thought of it, I am afraid.

Q. Do you now consider yourself under any obligation so to do?

A. Well, you know this whole field is one that has been under a great deal of discussion and delineation in the last few years, and my thoughts were changing right as we went along, and I think that I would be most punctilious about either not having investments of that sort or certainly telling them about it, having it recorded, but there are difficulties when you are in the same area of investing funds similarly to other people and when you are with a group working together you can pick out areas where you can say, ‘Well, did I ever know what everybody else was doing’ and certainly it never occurred to me I was under a duty to do it. I would have been glad to do it. I don't think it would have made the slightest difference to them, but if it would have, I would have abided by any decision. It is a very difficult area.

Q. It was hardly open to them though, to make a decision when they didn't know you were a shareholder?

A. I agree, yes.”

Thereafter I intervened myself to put some questions to the witness and his answers were considered and instructive.¹⁴

“THE COMMISSIONER: Mr. Gregory, you have used the words discuss and delineate and that is what I have to do in connection with some of the activities of directors and companies and officials.

And do I understand you to say, that the climate now, has changed from what it was then?

A. It has sir, and I would like to possibly have more time to go into this with you, because I could see it changing and in thinking back five years, you ran into various things publicly—such, well for instance, Carol Shanks got into trouble with Prudential over in the States, which

¹³Evidence Volume 115, pp. 15697-8.

¹⁴Evidence Volume 115, pp. 15698-701.

was quite a shock because he had some conflict of interest there with the company, and then there was more discussion with the stock exchanges coming up and what—whether their firms—a firm's member, should be holding shares in which the firm was interested.

There are a great many of these grey areas which have been explored over the last few years and I think that much stronger positions are taken. It is rather ironic when it is claimed that public morality is getting worse or easier, that the morality or the ethics in financial institutions and in these whole areas are becoming much stricter and much more rigidly defined, and I quite agree with it and I think they should be defined and set out so that you are conscious of them. You think about them instead of being totally unaware of any problem.

Q. Yes. I am particularly interested of course, in the area of disclosure of interests which might be contrary to that of the company, and I understood you to say, that you were not surprised that even though your interest was as you say, disclosed to the directors, such disclosure is not recorded in the minutes?

A. No, because there was no conflict of interests, sir.

We were just—we were both buying shares in the same company. There is no problem with that.

Q. Companies to which the trust company was making loans?

A. 'Twasn't at that time, sir.

Q. Not at that time, no?

A. 'Twasn't until some considerable time later that any loans were made.

Q. And apart from that, making loans, the company was being asked to make an investment which surely would improve the prospects of the company in which you among others, have private holdings?

A. No. You see, we went into this thing together. The company was offered the money. There was offered there 20 per cent or should I say, I was offered an interest. I said, 'The company would take 20 per cent which was their limit'. There were more shares available at the same price. I saw no problem whatever in saying I would buy some of those. I thought I was supporting the company's position by doing so.

Q. I heard very much the same argument advanced by Mr. Christie in the case of the General Spray Services debenture which he held, and he however, finished up by saying, that he thought he had made a mistake and that it was undesirable that he should be in that position.

Do you share that view?

A. Yes, I do now, simply because of what people can say. Not because there is anything wrong, but stock exchanges I think in the United States about a year ago, finally came out with a pronouncement somewhat along the same lines, that there shouldn't be—you shouldn't be in the same interest even just because of the fact that somebody may be able to say, 'It doesn't look right' and, as I say, the whole area is getting much more strict."

This point of view is on the whole consistent with that adopted in Wilfrid Gregory's correspondence with the Registrar of Loan and Trust Corporations. He appeared to say that where laws are silent as to standards of conduct in business no such standards are binding. It is this attitude, of course, which has more than anything else precipitated legislation in all jurisdictions of a stringent character, by which the conduct of businessmen is regulated in accordance with standards which the great majority have openly subscribed to all their lives. Gregory's literal and legalistic approach to the question of morality in business matters is an important factor in understanding conduct which must, nevertheless, be judged unacceptable in the management of any company, particularly one acting as a fiduciary and commonly believed to be maintaining the highest standards of prudence and integrity. His declaration made on the occasion of the dismissal of L. W. Facey, that "there can be no compromise with absolute integrity and loyalty on the part of any employee in a financial institution", contains a disturbing note of self-righteousness which, in the context of the several transactions which have already been described, seems to be unwarranted.

A further example of Gregory's impulsiveness in the part he was called upon to play as the president of a Canadian trust company may be included here. One of the first fruits of his assumption of the direction of British Mortgage & Trust Company was a dispute with the Department of National Revenue (Taxation) at Ottawa over its assessment for the year 1958. In the published annual report of the company for 1960 there appeared the following paragraph in the report to the directors made by the vice-president and managing director:¹⁵

"You will notice in the Profit and Loss Statement a provision for \$30,000 for income taxes for the year 1958. This arises because the Department of National Revenue is attempting to tax the gains made as a result of the sale of securities in 1958 in our Company account. This was an unwelcome and unexpected step by the Government, and is being strongly resisted by your Management. It does not seem to be enough that we pay 52% of our income in taxes, but now the State wants to seize the capital itself."

The sobriety of this statement, made for the benefit of the shareholders and the public, may be better judged by reference to the managing director's confidential report to the board of directors on this subject about a week earlier.¹⁶

"The Department of National Revenue did not like the fact that in 1958 we had a net profit of some \$77,000 on the sale of Company securities, and a net loss of \$47,000 on the sale of Guaranteed securities, which is deductible from income for taxation purposes. They have claimed that the \$77,000 should be added to our income. We feel that

¹⁵Exhibit 4251.

¹⁶Exhibit 4281.

this is entirely unjustified and have retained first-class legal advice in Messrs. Stuart Thom, Q.C. and J. D. Arnup, Q.C. Without going into all the details, it will suffice to say that we are strongly resisting this claim.”

It will be recalled that the revenue authorities in fact permitted capital gains on securities in the company accounts of trust companies to be free from income tax and accordingly did not allow deductions for losses; it was otherwise with the guaranteed funds account, where capital gains were taxed and losses allowed to be correspondingly deducted. The gravamen of their complaint was that the company had allocated its unprofitable investments to the guaranteed account and the profitable ones to the company account in the course of the taxation year, so that it could deduct its losses on the former and save its profit on the latter from tax. In spite of Gregory’s pledge of firm resistance there was no resort to litigation, and British Mortgage & Trust eventually paid \$168,000 in settlement of assessments not only for 1958 but for all the years thereafter up to and including 1963, and acceded to the department’s demand that it henceforth account for income on an accrual rather than a cash basis, with consequences which resulted in fresh deception of the shareholders and the public.¹⁷

The President’s Files

For almost exactly a month after Harold Lawson suggested the resignation of Wilfrid Gregory to him and his father, before the board meeting of June 29, the former continued at the helm of British Mortgage & Trust, in spite of what he described as loss of confidence in him by his fellow-directors and by him in himself. Not until July 27, 1965, when the agreement with Victoria and Grey Trust Company fell to be considered once and for all, and the very existence of British Mortgage & Trust was at stake, was he induced to resign by the attitude of Victoria and Grey Trust itself, as conveyed to the board by Lawson. But the habit of years, and the necessity of making some final and irretrievable arrangements, kept him on British Mortgage premises for a few days after his dramatic exit from its board room on July 27. Lawson, who became the new president, has described how Gregory telephoned to him in Toronto, probably the day after this meeting, and indicated that he was still in his old office.¹

“ . . . I was greatly surprised at that, and I told him that he shouldn’t be there since he had resigned the presidency, that he could do more harm than good by being in the office and that he should get up and get out. And I think I advised him to get out of town for the time being.

¹⁷Exhibit 4281.2.

¹Evidence Volume 119, pp. 16182-3.

But I must say that my concern was mainly with the problem presented to the staff of divided loyalty, and so on. I think to the end, and probably to this day, why, a lot of the staff were very loyal to Mr. Gregory, and since the new president of the company was not there, why, obviously, even though he had no office, he was in a position to continue to run the company if he was in the office. I think it was just a disturbance."

But there was evidently a reason for Gregory's return which he never imparted to Lawson. Quite early in the investigations of the Commission it encountered rumours that after he had resigned he had burned his own files. When it became clear that there was substance to these reports his counsel was informed and advised that, because of the absence of many letters and documents in the files in the possession of Victoria and Grey Trust Company which should in the normal course have been there, questions would be put about the reported destruction of his files when he was called upon to testify. At the opening of his testimony to the Commission on April 26, 1947 he produced, in compliance with the Commission's request to produce all documents in his possession relevant to its inquiry, two files, one entitled "Atlantic Acceptance 1959", and the other "Atlantic Acceptance Corporation 1960-1961".² The examination which followed must, in fairness to all concerned, be reproduced at considerable length.³

"MR. SHEPHERD: Is it fair to say Mr. Gregory, speaking generally of the contents of those files, that they consist of notices of directors meetings, minutes of meetings of Atlantic Acceptance, some financial statements and correspondence, in which you are stating whether you will or will not be in attendance at the next meeting, of which you have received notice?

A. That is fair, sir.

Q. Mr. Gregory, I must put to you this, information came to the Commission to which I called your attention a couple of weeks ago, generally to the effect that in your own office, and in the office of your secretary, you had up to the latter part of July, 1965, a number of files, perhaps in the order of fifty, which files you caused to be destroyed at about the end of July. Would you please state when this occurred, and under what circumstances, and what files they were?

A. Well, Mr. Shepherd, I don't think I caused to be destroyed any files of British Mortgage and Trust. There were a number of files of my own that pertained to these various associations and organizations with which I was active all during my professional career from 1936 on, which were in two filing cabinets in the basement. These, when I was told to clear out my desk, and leave, I went down to the janitor and said, 'What are we going to do about these?', and he said, 'What do you want to do

²Exhibits 4624-5.

³Evidence Volume 115, pp. 15511-24.

with them?', and I said, 'I have no place to take them, you might just as well get rid of them', and in actual fact he did get rid of one of them, I believe, but there is another one still there of four drawers, I think, all these various things dealing with the Festival and Industrial Commission, the bar association and all this type of thing that had absolutely nothing to do with British Mortgage, none of these files did.

Q. We did not find any personal correspondence files, or files relating to your investments, as for example, your personal investment in Aurora, did such files exist?

A. There were none. May I say one further thing, one further explanation on this, when I first—we were building a new office building for British Mortgage in 1962, and when we moved in I was quite concerned about the amount of space that it took for files and this sort of thing and I decided that we would try a different system, if at all possible, and after that my own procedure practice was to keep personal files for the full year, like this year—1965 files that had been destroyed at the end of 1966, when I opened up 1967, so I would have part of a year, and then one full year, and then they would be thrown out, but these personal files were not kept with any British Mortgage files.

Q. I was not referring really to British Mortgage files, Mr. Gregory, but to files which were your own personal files, in which I understood were in your office or the office of your secretary, are we speaking of the same files?

A. I presume so, yes.

Q. And did those files not include any files, for example, relating to the affairs of Aurora Leasing Corporation?

A. No, no, there were not any files, you could say that most of these things are done by telephone, correspondence does not enter into it a lot, but let me think, personal files would be the sort of thing where we write congratulatory letters, and got tickets for the Festival for people and all this sort of thing. As for Aurora, I don't of course recall what we would get there, when I would buy some shares, this would be usually done with a broker by telephone, he would send them up, I would keep the slip until I had entered it into a book, and then I would throw the slip away. I did not keep those things at all.

Q. Let us take for example one transaction, with which we will be dealing later, the transaction with Messrs. Marron and Keon, solicitors in Owen Sound, respecting an I.G.A. store. There is correspondence in evidence obtained from the solicitors, and we did not find the originals of those documents at British Mortgage or in your possession. Can you assist us as to what would have happened to documents such as that?

A. As I recall, I left Mr. Pike to handle all that correspondence in that transaction, if by chance I had written a letter, I suppose that the copy might have gone to my personal file, but I tried not to get involved. My whole endeavour was to keep detail off my desk.

Q. Let us take as an example—there is no particular significance to the letter it is a letter, the original of which is found in the possession of Mr. Morgan, in his files, and I show you a photocopy of it, dated 25th November, 1964, addressed to Mr. C. P. Morgan reading as follows:

‘Dear Powell,

Re Fredericks and King—our discussion last week.

I find that we paid King about \$3,000 but we were under no compulsion to pay him. It was purely a matter of goodwill. I do not know whether this will be of any help to you or not, but I hope so.

Yours sincerely,

“Wilf.” ’

And underneath it in handwriting,

‘P.S. B.M.&T earned \$1.49 per share V. \$1.24’.

Have I read that correctly?

A. Yes.

Q. Now, can you help me as to where the carbon copy of let us say that letter would normally be?

A. I haven’t any idea. My secretary would take that copy and I presume that she would put it in a personal file because it was written on a personal matter. I expect that. Do you want to know about the contents?

Q. Well, we will touch it when we come to it, it is of no particular significance, Mr. Gregory.

A. No.

Q. Well—please go ahead?

A. My personal files, my own particular personal files, which I had been told to remove and take away, when I left, were just—I have some of them actually—it was very difficult at the time, there was no commission there was nothing else, it was a matter of disposing of nuisance stuff, and I kept, I suppose, a few letters that I would need for the future, about half a dozen streamlined stuff, and threw the rest away.

Q. Are the letters to which you refer, letters which relate to the matters before this Commission?

A. Not a bit, they are bank affairs, affairs about my children’s educational things, and this sort of thing.

Q. Yes.

THE COMMISSIONER: You did, Mr. Gregory, take some files away?

A. Yes, I did, sir.

Q. Can you give me a rough idea how many there would be, a large number?

A. I am sorry, I could have brought them down, I still have them in my desk, I kept them in the one drawer. I know that because my secretary has a system which I did not particularly like, but they are attached to a cardboard, and I looked over them actually two days ago, to see if there was anything there that pertained to anything here, and they were there, and they are of no significance. But, I was told—when I took things away I felt that if I left things there that I would have been able to have later, but I didn't feel I should take them—such things as my managing directors report, even the annual financial statements from the auditors, I just left them in the drawer of my desk and it was more a matter of leaving things tidy and clean than wanting anything.

MR. SHEPHERD: Had you had a conversation with Mr. Farlinger of Clarkson, Mr. Gregory, during the first half of July, at which he advised you of some of the transactions which had come to his attention in connection with Aurora Leasing Corporation, Limited, to take an example, and did you express some dismay at the information he was telling you?

A. I think it was on the 18th of June.

Q. Probably so.

A. It was the time that Atlantic was dropping. And I came down here, and a mutual friend phoned me, Mr. King of Annett and Company, who had been instrumental in promoting a lot of these things with me and knew Farlinger, and he heard something about this and said, 'Well, we must go over and see about this Aurora because I hear disturbing things.'

Q. Did he tell you things which were new to you and caused you some distress?

A. This, I think, caused me the most distress of almost anything.

Q. Is it fair to say he was speaking of matters which, if true, indicated some impropriety in the management of Aurora?

A. That is correct.

Q. Then, there was a great deal of publicity, as I recall, about an Ontario Securities Commission investigation which was to be held into the affairs of Atlantic, was there not? This was in the latter part of June and the early part of July?

A. There may have been; it didn't make any particular impression.

Q. I see.

A. I guess I knew that there was talk of different people looking into Atlantic.

Q. From memory, I believe, that your resignation from British Mortgage and Trust was the 27th of July, 1965. Is that correct?

A. I believe so. It is the last week of July.

Q. Would that be the day on which the files were dealt with?

A. That is correct.

Q. Mr. Gregory, with the advantage of hindsight, do you agree that to destroy any files under those circumstances was ill-advised, in that it would be possible in some investigation some construction adverse to you would be put forward?

A. Well, Mr. Shepherd, if I had ever thought that, I certainly wouldn't have destroyed them and, unfortunately, I have not been able to take this seriously because it is such an innocent thing. What can I do with these things? They were there, I was told to clean out and get out and I never thought of them as being—as pertaining to anything to do with Atlantic Acceptance, or anything else. This was the record of my career outside of business. And there were even investments; I don't think there is any question of investments being in them. It just is so immaterial.

THE COMMISSIONER: Do I understand that the files we are now talking about were all in the basement?

A. That is correct, sir.

Q. And kept in the basement as a matter of course?

A. They were in a storage room down in the basement. There were two filing cabinets of them.

MR. SHEPHERD: Were there files also kept in your office and in your secretary's office?

A. I had in my large drawer in my desk the current year's personal file, where I did my own filing of these things, and the previous year that I said were kept, would be in my secretary's file, under her control.

Q. It is to those files that I refer. Were those files not destroyed on this occasion?

A. My personal files were, yes.

Q. We are not speaking of files in the basement, we are talking of files in your office and your secretary's?

A. They were the same type of files which went downstairs at the end of the second year or were totally destroyed, and this was merely all of it before. It is the same. None of them—I have said that.

Q. Do I understand—

A. I just had no concept these things meant anything, would be required for anything. As I say, there was no Commission set up and, in any event, even if there had been, I don't imagine it would have occurred to me that these particular things had anything to do with Atlantic Acceptance or dealings with them. And, you must admit, at that time, looking ahead, what can you say today, what file would be required with something—

Q. I should have thought, Mr. Gregory, as a director of Atlantic, a large shareholder of Aurora, a director of N.G.K., that any files pertaining to the operations of those companies or—including correspondence between any of the officers of those companies and yourself, would probably be files you would particularly wish to keep. But, in any event, you did not?

A. These are the only two that were found, and I don't think they are of particular significance.

THE COMMISSIONER: I think you mentioned the fact there were Canadian Bar Association files amongst ones that were destroyed?

A. Year after year of them.

Q. You were vice-president for Ontario of the Canadian Bar Association?

A. I was. I was on the council for nineteen years; I was chairman of the Investment Committee for four years, and various others.

Q. And, indeed, you are a bencher of the Law Society of Upper Canada?

A. That is correct.

Q. Why would you have those files destroyed?

A. I hated to do it, but, if you knew what I was going through at that time, and I was going through it for six weeks, I was in a state of mind, my career was finished and there was no use keeping these mementos. When we moved out of our large home we not only destroyed files, we destroyed almost all our personal family mementos. We had no place to go, no place of putting them, and this was the compelling reason for getting rid of impedimenta.

Q. You must not mind me pressing you on this.

A. Not at all.

Q. I think the fullest explanation of why this was done should be given to the Commission.

MR. SHEPHERD: Is there anything else you wish to say on that particular point, or should we pass on?

A. I don't think so. Sorry."

This evidence was so much at variance with what the Commission had been led to believe about the location and nature of the files which had been destroyed that it was decided to seek information from Mrs. G. M. Hottot, residing in London, Ontario, who had been employed by British Mortgage & Trust Company as Wilfrid Gregory's secretary from June, 1964 until shortly after his resignation. The relevant portion of her evidence must also be given at some length.⁴

⁴Evidence Volume 118, pp. 16119-28.

“Q. Did Mr. W. P. Gregory have any files which were not kept in the general filing system of British Mortgage & Trust Company?

A. Yes.

Q. Where were these files kept?

A. Had two drawers of files right next to my own desk plus files he had in his own office.

Q. Are the drawers to which you refer filing cabinet type of drawers?

A. No, it was a sort of a teak that was one long semi-circle with a desk at each end and filing cabinets in the middle.

Q. How many files would you judge there would be in the two drawers?

A. At least fifty files.

Q. Then did Mr. Gregory have other files, you say, in his office?

A. Yes.

Q. How numerous would they be?

A. One desk drawer very full.

Q. What would be your best estimate of the number?

A. I think at least forty files.

Q. Can you assist us as to generally the nature of those files?

A. I am afraid I can't. I never saw them.

Q. Were they documentary, I am speaking now—I am sorry—of the files in your office?

A. I am sorry?

Q. Were the files in your office files of documents or what were they?

A. No, correspondence files.

Q. And can you help us at all as to the matters to which those files related?

A. Yes, the files were files of different associations that Mr. Gregory belonged to.

Q. Yes?

A. And the better part of the second drawer was full of an alphabetical group of files listing the companies he was involved with.

Q. Let's take first then the associations, can you give us an example of the type of association you are speaking of?

A. Yes, things like the Stratford Shakespearian Festival.

Q. Yes, then let's come to the—I don't want to put words into your mouth but would there be a file for example relating to the Bar Association or Law Society of Upper Canada?

A. Definitely, yes.

Q. About how numerous would you say the files would be relating to the companies?

A. Well, I would say not quite half but close to half.

Q. Yes, something less than twenty-five then?

A. I think around that.

Q. Yes, can you assist us at all as to the names of any of the files which you have referred to as 'company files'?

A. Yes, the Atlantic Acceptance file.

Q. How many files were there of Atlantic Acceptance?

A. I believe there was a correspondence file and a minute file, minutes of meetings.

Q. Yes?

A. Commodore Business Machines, Severn Investments, Aurora Leasing, N.G.K. Investments, there was a file on the Dale Estate, Monsanto file.

Q. M-o-n-s-a-n-t-o?

A. Yes.

Q. Yes. Did you prepare a list?

A. Yes.

Q. There would be no objection to you assisting your memory by looking at your list. The Registrar may get it.

A. One I did not mention perhaps was Treasure Island Gardens.

Q. Yes?

A. There was one, I believe, Associated Canadian Holdings and I believe there was a Kelton and I believe there was a file called Caribe Island Properties.

THE COMMISSIONER: That would be 'C-a-r-i-b'?

A. 'C-a-r-i-b-e', I think.

THE COMMISSIONER: All right.

THE WITNESS: That is about all I can recall.

MR. SHEPHERD: Yes. Let's take the Treasure Island file, what is the nature of it, is it a correspondence file or a document file?

A. Correspondence file.

Q. About how voluminous would it be?

A. Oh, I would say there was a fair amount of correspondence, certainly not enough to fill up one file folder, perhaps.

Q. Can you assist us at all as to the persons from whom letters were received or to whom letters were written in connection with that file?

A. I am afraid I really can't.

Q. Yes. Let's come to Atlantic Acceptance, the correspondence file. Is there any person in connection with that file whose name comes to your mind?

A. I think the correspondence mainly dealt with Mr. Morgan, Powell Morgan.

Q. When you say 'deals' with him, do you mean addressed to him or received from him or simply relating to him?

A. No, received from him and addressed to him.

Q. Yes. What of Commodore Business Machines?

A. People that we wrote?

Q. If you can remember, do not hesitate to say if you can't?

A. I am afraid I can't.

Q. Aurora Leasing Corporation?

A. No.

Q. Perhaps rather than go through the files one by one, are there any names other than Mr. Morgan's name whom you recall as being persons to whom letters were addressed or from whom letters were received?

A. Well, one other person was Mr. Jack Tramiel, but I do forget which company—

Q. Yes?

A. —it came.

Q. Were there any files relating to investments, by this I mean files which would contain, for example, confirmation slips relating to share purchases or sales?

A. No, definitely not.

Q. There were not any confirmation slips?

A. No.

Q. Was there any correspondence, do you recall, with any brokers?

A. No.

Q. In connection with The Dale Estate, to which you referred, can you recall the name of any person written on that matter?

A. No I can't.

Q. What persons do you recall came to see Mr. Gregory of these persons, did you ever see Mr. C. Powell Morgan?

A. No I didn't.

Q. Mr. Jack Tramiel?

A. No I don't believe so.

Q. Mr. Carman King?

A. I believe I have seen him.

Q. Yes, was there any correspondence to or from Mr. Carman King?

A. Quite a lot, yes.

Q. Do you recall in what file that would be found?

A. No I don't.

Q. Yes, is there anything else on the nature or the contents of the files on which you can help us or is that about the extent of your recollection?

A. I think it is, yes, except that they were, as I said, pretty well all correspondence files, no documents or anything like that.

Q. Yes, thank you. Now was there an occasion towards the end of your term of employment with British Mortgage when something was done with those files?

A. Yes.

Q. When did this happen?

A. I believe it was the last day that Mr. Gregory was there in the afternoon he, in these two drawers of filing cabinets we had a typed out list of the files in order as you would find them in the drawer and he asked me for the list and he brought it back saying that the files he had ticked off he would like me to give to him and the rest he would like me to throw away, to put in some cardboard boxes that would be taken down to be burned.

Q. Do you recall how many files you gave to him?

A. No I don't.

Q. Can you assist us in any way as to what proportion were given to him?

A. Definitely not half of them anyway, there may have been probably ten or fifteen files.

Q. Yes. Do you recall which files they were or anything about generally the nature of the files given to him?

A. I can't recall at all which ones they definitely were. Looking back on it I can imagine some of them he definitely would have kept would have been some of the personal files like the Festival file, things like this he would still be connected with and then some of the files he had, the company files had quite a bit of correspondence in them like Atlantic and Monsanto, I would imagine he definitely wouldn't want them thrown away.

Q. Do you say that because it strikes you as reasonable that would be the approach?

A. Yes.

Q. Or because you recall?

A. I can't recall.

Q. Then what did you do with the files he wished thrown away?

A. They were put in cardboard boxes brought up by the janitor.

Q. And what happened to the boxes then?

A. They were taken away.

Q. How many boxes were involved?

A. I am not sure of that. I can remember at least two.

Q. Yes. Could you give us an approximate idea of how large a box we are speaking of?

A. Well, I thought the boxes would have been at least two or three feet high and quite large.

Q. Yes, and are you able to say—perhaps you are not able to say—approximately how full they would be?

A. Not really. Over half full anyway. I cannot really remember.

Q. You said this was the last day on which Mr. Gregory was in the office, is that correct?

A. I believe it was.

Q. Is this the same day as the day on which he resigned as president, can you recall?

A. No.

Q. Can you assist us then as to the date in relation to the date he resigned as president?

A. I believe it was a couple of days previous that he spoke to the staff telling them of his resignation.

Q. I see, there was a day then, I take it, Mr. Gregory spoke to the staff and told them what? That he had resigned?

A. Yes.

Q. And then this day on which the files are dealt with, is that after the day on which he told the staff he had resigned or before?

A. I believe it was after.

Q. Yes, about two days after, did you say?

A. Just a couple of days.

Q. Was that the last occasion on which you saw Mr. Gregory?

A. I saw him just for a couple of minutes in the office two or three months later. A month later.

Q. I take it you have not spoken to him since that time?

A. I have just seen him once, just on the street."

Arthur Albert Shaw the building superintendent at the head office building of British Mortgage & Trust Company in Stratford was also called

and gave his evidence on the same day, immediately following that of Mrs. Hottot.⁵

“Q. Do you recall an occasion on which something was done about some files of Mr. W. P. Gregory?

A. Yes, sir.

Q. What can you tell us about it?

A. Well, a couple of days after he had called the general meeting, which was, I believe, the 27th of July, he called all the staff together to tell us what had happened and that he was leaving and a couple of days after that he contacted me, both personally and by phone, to take a couple of cartons up to his office for files which he wished to dispose of.

Q. Yes?

A. And after I left the cartons there and he cleaned out his lockers or his cupboard and then the stuff was taken up to the penthouse where we have the incinerator and it was burned.

Q. How large were these cartons?

A. I would estimate about thirty inches square, just large cartons.

Q. And were you present when they were put in the incinerator and burned?

A. Yes, I was.

Q. Can you help us as to approximately how many files were burned?

A. The boxes were fairly full but they weren't in file formation, just like loose paper dumped in so I would not know just how many files actually.

Q. Yes, did you take occasion to look at any of these documents?

A. Just glancing at the top as they were put into the incinerator, what was loose on top.

Q. Can you help us at all about the nature of these two boxes?

A. From my observations it was personal letters in connection with the Shakespearian Festival and maybe the odd thank you letter from people who had received complimentary tickets and things like that.

Q. How many of the letters did you look at?

A. I would say maybe half a dozen happened to have the typed side up on top of the wastepaper.

Q. Were these documents correspondence?

A. Yes.

Q. How full do you say these boxes were?

A. Oh, there would be some of them might be three-quarters full.

⁵Evidence Volume 118, pp. 16130-4.

Q. Did you see Mr. Gregory again in connection with files?

A. I did give him a couple more boxes to clean out a file down in the basement which was, I believe, the following day, around that time, anyway.

Q. Where were these files kept?

A. In what we call the 'valuable files room', down in the basement.

Q. And how many files would there be?

A. I think in that there would possibly be maybe thirty or forty files there but then again when he emptied them he just dumped them out into the box so they were loose.

Q. Are you able to say what those files were related to?

A. No, I believe that—well some of them—it was in connection with the Shakespearian Festival again, but just what I could see from the top.

Q. How much of it did you see?

A. Just the odd loose paper that was on top of the box, the wastepaper.

Q. And how many boxes, if more than one, did those documents fill?

A. Two, there would be two cartons.

Q. So in all there were four cartons of papers, is that correct?

A. Yes.

Q. And the total number of documents you would have seen would be what? In the order of ten?

A. Yes, no more than ten.

Q. You can't assist us further than you have then, as to the contents?

A. No, sir.

Q. When these files were destroyed what was the normal practice as to the timing of the destruction of the files of British Mortgage after they had been delivered for destruction?

A. Well, we used to keep them for a period, at that time, we were keeping the paper, the stationery in the wastebaskets for a period of two weeks before they were destroyed.

Q. What was the reason for that?

A. It was more or less to assist in the banking, if any correspondence came in and people had said they had mailed cheques in and the cheques had been mislaid or that sort of thing and to check through it.

Q. Were these particular files the ones that came from Mr. Gregory's office, were they destroyed the same day as he filled the cartons?

A. Well, we started to burn them that day, but we only have a small incinerator so it just took a couple of days before we actually—because we were burning other wastepaper besides those.

Q. Yes. Did you have any discussion with him as to when they would be destroyed?

A. No, not that I recall.

Q. When did you last speak to Mr. Gregory prior to today?

A. I haven't spoken to him for some time now although I have seen him on the street several times."

As may be imagined, both these employees, who because of publicity in the press must have been fully aware of the significance of their testimony, gave it with some reluctance. It is clear from the evidence of Mrs. Hottot that there were personal files of Gregory's, not kept in the general filing system of British Mortgage & Trust, but in his own office and that of his secretary, dealing with Atlantic Acceptance Corporation, Commodore Business Machines, Severn Investment, Aurora Leasing Corporation, N.G.K. Investments, The Dale Estate, Associated Canadian Holdings and Treasure Island, containing correspondence with C. P. Morgan, Jack Tramiel and no doubt many others, the contents of which might have served to shed considerable light on the transactions with which the Commission was concerned and in areas where obscurity still prevails. That these files existed as Mrs. Hottot described them, and greatly exceeded in magnitude the two files of purely formal documents without correspondence which Gregory produced to the Commission, there can be no doubt, particularly since the discovery of some original letters from him in the files of other individuals and companies, of which no copies have been preserved in the British Mortgage & Trust files, was at an early stage a source of concern to the Commission. Having heard Mr. Gregory's evidence on the subject, as quoted above, and read and re-read it many times, I have been compelled to reach the unwelcome conclusion that he endeavoured to mislead the Commission as to the contents of his files and as to his reasons for ordering their destruction. Making every allowance, as I must, for the extreme distress of mind under which he laboured at the time of his resignation and afterwards, I find this course of conduct to be wholly indefensible and without excuse, except as a means of removing from subsequent scrutiny evidence about which he entertained feelings of guilt.

Concluding Reflections

The preceding account has closely followed the evidence offered to the Commission, both at the public hearings and in the form of examinations taken under the provisions of the Securities Act or voluntarily from various witnesses, all of which was given under oath. A large quantity of documents in the form of tables prepared by the Commission's accountants and files furnished voluntarily, particularly by Victoria and Grey Trust Company, or under compulsion of subpoena by others,

has supplemented the verbal evidence throughout. Finally information from many quarters, the origin of which has generally been disclosed, has been used as occasion required.

It has been seen that from the time that Wilfrid Gregory assumed responsibility for its affairs the operations of British Mortgage & Trust Company were greatly expanded, not only at a pace appropriate to the times but accelerated above the average. During this period the main increase in assets was in the mortgage portfolio, with a loss in consequence of liquidity and, within this category, a marked multiplication over any previous period at increased risk and correspondingly higher interest rates. Two significant elements of the company's structure failed to keep pace: estates, trusts and agencies, the principal business of a trust company, lagged behind the pace of growth, and increase in the shareholders' equity was notably slower than would appear to have been warranted by the increase in assets. The company continued, in spite of its expansion, to look and function like a loan corporation rather than a trust company, except that, because borrowing as such from the public was prohibited to trust companies by the Loan and Trust Corporations Act, its activities were directed to the analogous field of deposit-taking and the receipt of funds for guaranteed investment. In this respect it invested heavily in the opening of branch offices, not only in the rural areas in which it had been accustomed to operate but also in Metropolitan Toronto.

Attention has been drawn in particular to the stubborn arguments addressed by Gregory, as chief executive officer of the company, to the Registrar of Loan and Trust Corporations and his officers in opposition to their cautionary observations about the company's investments and about the calculation of the sum of its capital and reserves, affecting its ability to invest in any one company. In the resolution of this controversy British Mortgage & Trust was assisted by the imperfections of the Act, particularly section 142 as it was written at the time, and the fact that the Act did not draw a distinction between general and allocated reserves. It has been observed that the Registrar and his officers foresaw and warned against the practices which led ultimately to the downfall of British Mortgage & Trust, but, because of inadequate staff and unrealistic sanctions, were unable to act in time to prevent it. In fact their efforts were hampered by the attitude of the president of the company who not only disputed their conclusions but misled them as to the facts of his company's situation. Of all the examples of deception practised by the company under his direction the effect of the change in accounting for income from a cash to an accrual basis for the fiscal year 1964 was the most considerable. Although it may be felt that the company's auditors made only a feeble effort to secure the inclusion of a note to the balance sheet for that year which would have directed the attention of the public to the fact that its operations had been less profitable

than in the preceding year, rather than more profitable as they were made to appear, it should be said in extenuation that auditors at the time were not as well equipped by law and custom as they now are to compel adoption of their views as to the form and details of financial statements.

The obliteration of the shareholders' equity in British Mortgage & Trust Company was, as described at some length, entirely due to the losses suffered in the funds committed, either by direct investment or by loans secured by its shares and obligations, to what has been called the "Atlantic complex", a group of companies and individuals of which C. P. Morgan was the protagonist. The fact that the investments and collateral loans of the trust company had become increasingly concentrated in this direction, to the extent of some 60% of the whole, had been discerned by the Registrar's office and, as a result, Wilfrid Gregory had been persuaded by the emphatic intervention of the Registrar himself to call in at least the loans made to individuals, "all of them millionaires". By this time it was too late and the failure of Atlantic Acceptance Corporation on June 14, 1965 led directly to the difficulties of British Mortgage & Trust, resulting in its absorption by a competitor on hard and unpalatable terms. The connection between Atlantic Acceptance and British Mortgage was at first unperceived and, indeed, obscured by the confident assertions of Gregory; as has been seen, it was only revealed to the trust company's board of directors by the inquiries of Harold R. Lawson, a newcomer to their board and not under the spell of their chairman and his son. By this time the decline in the price of the company's shares had alarmed its depositors and there began that swift decline in deposits which threatened to close its doors, and was only halted by unusual and salutary intervention on the part of the government of Ontario. The extent of the internal disorganization of the company, amounting almost to panic, during the early summer of 1965 has been illustrated by the sale of its holdings of Atlantic securities, resulting in a preference given to its own account over the accounts of those for whom it acted as trustee in an astonishing, but probably unpremeditated reversal of the usual procedure and neglect of the obligations imposed upon it by law.

An examination of Wilfrid Gregory's investments show that, by 1963, by far the most considerable were his holdings in British Mortgage & Trust, amounting to some 14% of all the outstanding shares, and that he, together with members of his family, held about a fifth of the company's stock. To acquire this position he had borrowed over \$500,000 from companies which derived all their funds from Atlantic Acceptance of which he was a director; he remained in the invidious position of being able to defray the cost of this loan through dividends from his own company at a rate fixed on his own recommendation. Nevertheless there was no doubt about his own and his family's stake in

British Mortgage & Trust and he and they shared the losses of the other shareholders in 1965. His other investments were almost entirely in the Atlantic complex itself, were practically all disposed of as security for loans and were otherwise worthless. While he shared the misfortunes of British Mortgage & Trust in these investments, he was, by taking a position in enterprises to which it was contributing capital or loans, in a position to profit personally from decisions taken by him as its managing director. The same has been seen and concluded about a number of mortgage loans, such as those to Promenade-Swiss and Yonge-Eglinton Building and the Dale Estate. The mortgage loans to the Belfield companies revealed the personal participation of W. A. Pike, the mortgage manager, and L. W. Facey, the Toronto mortgage manager, contemporaneously with their authorization of advances of large sums to the companies in which they held an interest, to Gregory's knowledge and, until the situation became notorious, with his approval. The association of Gregory, Pike, R. A. Palmer and R. E. Hart for the purpose of buying and reselling at a profit a number of I.G.A. stores produced one recognizably improper transaction where the purchase was financed by a mortgage from the trust company and a profitable sale made to one of its beneficiaries. In the case of mortgage loans made to Tip Top Tailors, the Belfield group of companies and Conarm Developments the participation of Aurora Leasing Corporation was secured on terms which were disadvantageous to British Mortgage & Trust Company. Of these private activities its directors credibly maintained that they knew nothing, and it is certain that they were not disposed until too late to make pertinent inquiries.

Any account of the last years of British Mortgage & Trust Company must be dominated by the activities of Wilfrid P. Gregory, for from the time he took over its management in 1957 he, and he alone, set and maintained with great energy and singleness of purpose the course which ended in shipwreck and his own personal ruin. When he entered upon his task he was completely without experience of the trust company business, but with many natural advantages, improved upon by a record of useful activity for which he was generally admired in his native city, he was singularly free from existing preconceptions and entanglements. No suggestion of nepotism greeted his appointment and it has been seen that both father and son were entirely trusted by their fellow-directors and the shareholders of the company. Indeed, Wilfrid Gregory trod a larger stage than that of Stratford and had acquired reputation and friends in many fields across the country. But, from the beginning of his association with C. P. Morgan as a director of Atlantic Acceptance Corporation, he had participated eagerly in many of the ventures by which that ingenious and dishonest man had enriched himself and his associates, beginning with the sale of the minority interest in

Commodore Sales Acceptance to Atlantic, closely followed by participation in the operations of Aurora Leasing Corporation and N.G.K. Investments, the complicated and questionable transactions which floated and sustained Commodore Business Machines, the Treasure Island group of companies, and to a lesser but significant extent the affairs of Lucayan Beach Hotel Company and the Hugo Oppenheim Bank. To say that he was merely Morgan's dupe in these matters would be an unwarranted and misleading simplification, not only of the transactions in which he was involved with Morgan but of the many examined in this chapter in which he followed an independent path, and travelled it with associates and subordinates unconnected with Morgan's affairs. Throughout the period of his employment as the chief executive officer of British Mortgage & Trust Company Gregory played the part of a shrewd, aggressive, opinionated and, indeed, cynical man of affairs, setting little store by the scruples and traditional observances of the great majority of contemporary businessmen and with a dangerous aptitude for self-justification and self-deception. In case it should be said hereafter that, in the course of two full days of searching and revealing examinations many portions of which have been quoted in this text, he was the victim of bias or misrepresentation, one last quotation must be made of what was said at the conclusion of his evidence on April 27, 1967.¹

"Q. Mr. Gregory, dealing with the matters first which I have raised with you in the past two days. Is there any one of those matters in which you would like me to go further or to expand, or to deal more fully with? And secondly, is there any new matter which you would like to go into or like me to go into with you?

A. I don't think anybody could have gone into it more thoroughly, sir, and I think the only thing I wanted to end up by saying—and sometime I would like to have a talk with the Commissioner on some of these general subjects, but there is no time now, but I had about twelve or thirteen per cent of this company of British Mortgage & Trust and in retrospect I may have done things that were foolish, unwise, or which turned out not to be profitable.

I had made them \$2,000,000 in capital gains over the eight and a half years and some of this money we didn't mind assigning back into what were slightly risky propositions, but if which properly handled, would have been all right, but in any event, I was doing this for the sake of the company, not just for its own sake, but because this is where my money and my interest lay and I wasn't going to get involved in any other thing which would hurt British Mortgage. I am sure I was getting involved mainly to try and find ways of getting more, more business for British Mortgage and as far as myself is concerned, I wasn't certainly loath to earn certain extra money, if it was proper, along with the company, and in supporting the position of the company, but when it came down to my position as managing director of British Mortgage, the

¹Evidence Volume 116, pp. 15936-7.

decisions I made were based on what was best for that company, to the best of my knowledge.

That is all I can say, sir.

Q. Is there any other matter that you would like me to deal with Mr. Gregory, or have you had a reasonably fair opportunity to go into these?

A. I have had a very fair opportunity and I thank you for your courtesy, sir."

Gifted, affable, sought-after and acclaimed, Wilfrid Palmer Gregory was the respected head of a financial institution which was a familiar symbol of stability and strength, and which he did much to aggrandize and everything to destroy. The fact that his most destructive activities were concealed—and the evidence shows consciously concealed—from his fellow-directors, most of whom were old friends of himself and his family, must be conclusive in tipping the scales of judgment against him, and the final attempt to destroy the evidence in his files was as consistent with his previous conduct as it was futile in result. The Law Society of Upper Canada has found in one small manifestation of this conduct, but on broad and salutary principles, that it was unbecoming a barrister and solicitor. I must also find, regretfully but beyond doubt, that in many other instances, and over a prolonged period of time, it fell far short of what is expected of the head of a public corporation or, indeed, of any honourable man.

1196 4

57

(4)

BINDING SECT. MAY 12 1970

